Lectures on
LAW OF BANKING

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LECTURES ON LAW OF BANKING

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LECTURES ON LAW OF BANKING

LECTURE I
INTRODUCTION

(The Nature and Development of Banking)

This lecture covers –

(A) History of Banking System in India

(B) Different kinds of Banks and Financial Organisations

1. *Reserve Bank of India or Central Bank of India*
2. *Commercial Banks*
   - *(i) Commercial Banks under Public Sector*
     - *(a) State Bank of India and its subsidiaries*
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3. *Regional Rural Banks*
4. *Co-operative Banks*
   - *(i) State Co-operative Banks*
   - *(ii) Central/District Co-operative Banks*
   - *(iii) Primary Credit Societies*
5. *Development Banks*
   - *(i) Industrial Development Banks*
     - *(a) Industrial Development Bank of India*
     - *(b) Industrial Finance Corporation of India*
     - *(c) State Financial Corporation*
     - *(d) Industrial Credit and Investment Corporation of India Limited*

(ii) Land Development Banks

(State Level Land Development Banks and Primary Land Development Banks)

(iii) Agricultural Finance Corporation Ltd., and

(iv) National Bank for Agriculture and Rural Development (NABARD)

(v) Exchange Banks

(C) Types of Deposit Accounts

1. Savings Bank Account

2. Current Deposit Account

3. Fixed Deposit Account

4. Recurring Deposit Account

(A) HISTORY OF BANKING SYSTEM IN INDIA

The institution of Banking is of great importance and is playing a predominant role in the economy of every country in the world. The word 'Banker' is derived from the Latin word 'Bancho' or 'Banque', which means "a heap or mound". Similarly, it is derived from the German word 'Banc' or 'Banco', which means "joint stock fund". A Banker is one, who carries on banking business. Therefore, the word 'BANK' denotes "any person/individual or firm or company, who/which transacts banking business". In simple words, the word 'Banking' means "carrying on business with money". No economy in this world can function and there can be no growth and development of the nation without proper system of banking.

The institution of banking was prevalent as early as 2000 B.C. in India during Vedic period. In those days, merchants used to carry on business with people by accepting safe deposits and also to lend money to needy people. The Greek temples were used as depositories for people's surplus funds and were used as lending centers for lending at higher rates of interest against gold and silver, which had been left for safe custody. In India, during Vedic period, the ancient Hindu scriptures relate to the money lending transactions. Later, during the Smrity period, banking business was carried on by the people of Vaish community by accepting deposits and granting advances. During the Buddhist period, money lending business was well spread. Buddha and Mahavir considered money lending a sin and denounced it. During the Muslim period, money lending business in India was declined due to the strict Quoranic injunctions.

In the medieval period, the first bank known as "Bank of Venice" was established in Italy in 1157. In England, the credit for the institution of the modern banking system goes in favour of Goldsmiths in London. During the reign of Queen Elizabeth I, the goldsmiths in those days were carrying banking business by receiving/accepting the customers' valuables and funds for the safe custody. The goldsmiths used to receive gold and silver from the customers for safe custody and acknowledged the same by issuing receipts. These receipts meant for withdrawal, with passage of time became payable to the bearer on demand and it facilitated wide circulation. Further, the Goldsmiths transferred the deposits with them against the letters issued by their customers and this practice of transferring funds against the customers' letters became instrumental to the emergence of the modern/present cheque currency.

Goldsmiths suffered a serious set back during the reign of the King Charles II who issued a directive that no payment should be made to the Goldsmiths. As a result, the banking business by the Goldsmiths disappeared in course of time and it paved way for the emergence of the modern banking system.

In England, the first modern bank known as "Bank of England" was established in the year 1694. The first modern bank known as "The Hindustan Bank" was established at Calcutta in 1770. The first Presidency bank was established in 1806 and it was changed as the Bank of Bengal. Later the Presidency Bank of Bombay and the Presidency Bank of Madras were established in 1840 and 1843 respectively. These two banks were amalgamated into one bank, known as the "Imperial Bank of India". The Imperial Bank of India was nationalized in 1920 with change of its name as the State Bank of India, the largest bank in India at present, and is next to the Reserve Bank of India. By the end of 19th century, there were about nine banks. In course of time, several banks have been established.

The Reserve Bank of India was established on 1st January, 1935 under the Act called, The Reserve Bank of India Act, 1934 as the Central Bank of India. The Reserve Bank of India is playing a predominant role in regulating the banking business in India. The banking industry in India witnesses tremendous growth and development. 14 major commercial banks in 1969 and 6 commercial banks in 1982 were nationalized. The Government of India during the term of Shri. P.V.Narsinmha Rao in 1991 adopted privatization in trade, commerce and banking and as such number of private commercial banks viz. HDFC bank, Global Trust Bank Ltd, Hyderabad etc. have been established. With regard to the banking legislation in India the Joint Stock Companies Act, 1850 was the first legislative

enactment and the first commercial bank established under this Act in 1901 was the Oudh Commercial Bank. After independence in 1947, the banking industry in India witnessed tremendous growth and development and the Banking Regulation Act, 1949 was passed to regulate the banking system, organizational problems and to control the credit created by the commercial banks. The Act has been amended several times so as to meet the changing conditions and requirement in the banking industry.

(B) DIFFERENT KINDS OF BANKS AND FINANCIAL ORGANISATIONS

There are various kinds of banks and financial organisations, which were playing predominant role in the economy of our country as detailed below -

1. *Reserve Bank of India or Central Bank of India*
2. *Commercial Banks*
   - *(i) Commercial Banks under Public Sector*
     - *(a) State Bank of India and its subsidiaries*
     - *(b) Nationalised Banks and their subsidiary banks*
   - *(ii) Commercial Banks under Private Sector*
3. *Regional Rural Banks*
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     - *(d) Industrial Credit and Investment Corporation of India Limited*
   - *(ii) Land Development Banks*

(State Level Land Development Banks and Primary Land Development Banks)

(iii) Agricultural Finance Corporation Ltd and

(iv) National Bank for Agriculture and Rural Development (NABARD)

(v) Exchange Banks

1. RESERVE BANK OF INDIA

OR

CENTRAL BANK OF INDIA

The Reserve Bank of India is the central bank of our country. It was established as a body corporate under the Reserve Bank of India Act, 1934. It started functioning from April 1, 1935. It was first, a shareholders bank. It was nationalised with effect from January 1, 1949. It took over the function of issuing currency from the government of India, the power of credit control from the then Imperial Bank of India (State Bank of India at present). Its main functions are stated below –

(i) It issues currency notes.

(ii) It acts as Banker to the government.

(iii) It acts as Banker to the banks and lends the banks as a last resort.

(iv) It is a custodian of Foreign Exchange Reserves.

(v) It controls/regulates the credit created by the commercial banks and

(vi) It acts as a clearing house.

2. COMMERCIAL BANKS

The banks which perform all kinds of banking business and generally finance trade and commerce are called commercial banks. Since their deposits are for a short period, these banks normally advance short-term loans to the businessmen and traders and avoid medium-term and long-term lending. However, recently, the commercial banks have also extended their areas of operation to medium-term and long-term finance. Majority of the commercial

banks in India are in the public sector. But, there are certain private sector banks operating as Joint Stock Companies. Hence, the commercial banks are also called joint stock banks.

In simple words, commercial banks are those, which carry on banking business to earn profits. They borrow from the public by accepting different kinds of deposits at lower rates of interest and lend the same to the public by sanctioning loans and advances at higher rates of interest and thereby earn profits. The commercial banks may be classified into two categories namely –

(i) Commercial Banks under Public Sector and

(ii) Commercial Banks under Private Sector

(i) Commercial Banks under Public Sector : Commercial banks under the public sector are governed by the respective statutes. One such statute is the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. They include -

(a) State Bank of India and its subsidiaries viz.State Bank of Hyderabad and State Bank of Mysore etc., and

(b) Nationalised Banks (viz. Bank of India, Central Bank of India, Indian Bank, Canara Bank etc. etc.)

The Nationalized Banks are owned by the Government of India. The State Bank of India acts as an agent of the Reserve Bank of India, while the other Commercial Banks do not act as the agents of the State Bank of India. About 90 % of the country's commercial banking system is now in the public sector.

(a) State Bank of India : The State Bank of India occupies a unique position in our banking system. It is the biggest commercial bank with very vast financial resources and the largest number of branches. It has 7 subsidiary banks. Before 1920, the State Bank of India was known as Imperial Bank of India. In 1920, the Imperial Bank of India was nationalized with change of its name as the State Bank of India. Now, the State Bank of India is next to the Reserve Bank of India and acts as an agent of the Reserve Bank of India in the places where the RBI does not have an office or branch of its banking department. It has been conferred the status of the largest commercial bank in India. Its subsidiaries are

the State Bank of Hyderabad, State Bank of Mysore, State Bank of Travancore, State Bank of Bikaner and Jaipur etc.

Management : The affairs of the SBI is managed by a Central Board of Directors consisting of 15 members :

(i) The Chairman and a Vice-Chairman are appointed by the Government in consultation with RBI.

(ii) Two managing directors are appointed by the Central Board.

(iii) In the remaining 12 directors, 4 are elected by private shareholders, 4 directors are nominated by the Central Government in consultation with the RBI representing various economic interests.

(iv) The Central Government appoints one director and nominates one.

(v) The RBI nominates one director.

There is one ex-officio director. There are 14 Local Boards in the Country.

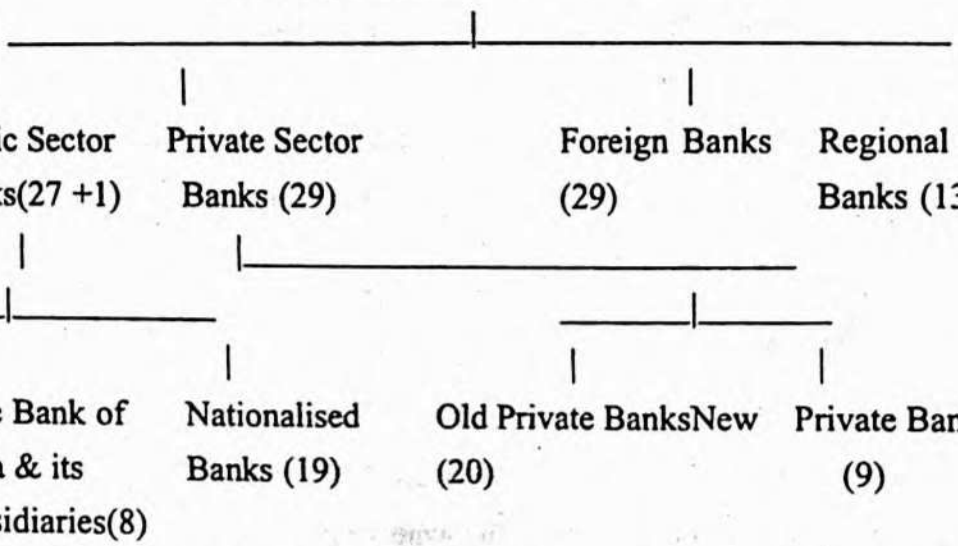
(b) Nationalised Banks : Where the ownership and management of banks is taken over by the state/ government, it is called "Nationalisation of Banks" and the banks are known as "Nationalised banks". The government of India on July 19, 1969 nationalised 14 major commercial banks and 6 other banks on April 15, 1980. Later, the State Bank of India and its 7 subsidiaries were nationalized. Among the banking institutions in the organised sector, commercial banks are the oldest, having the wide network of branches commanding utmost public confidence. There are about 28 banks, which constitute the strong public sector in Indian commercial banking. The nationalized banks do not act as agents of the Reserve Bank of India.

(ii) Commercial Banks under Private Sector : Apart from the commercial banks under the public sector, there are commercial banks under private sector, both Indian and Foreign banks, which are playing vital role in the economy of our country.

At present (March 31 2006) there are 220 scheduled commercial banks in India. Of these 28 are public sector banks, 133 are Regional Rural Banks, 29 Foreign Banks and 29 Private Sector Banks. The structure of commercial banking in India is shown in the following chart.

STRUCTURE OF COMMERCIAL BANKING IN INDIA

(MARCH 31, 2006)


Reserve Bank of India (Central Bank)
Scheduled Commercial Banks in India
Public Sector Banks(27 +1)
Private Sector Banks (29)
Foreign Banks (29)
Regional Rural Banks (133)
State Bank of India & its Subsidiaries(8)
Nationalised Banks (19)
Old Private Banks (20)
New Private Banks (9)

In addition to the above, 52 Urban Co-operative Banks and 16 State Co-operative Banks are also scheduled banks.

Role of Commercial Banks in a Developing Economy : A well organised and well developed banking system is a prerequisite for the economic development of any country. Commercial Banks in our country are playing significant role in the economy of our country. Commercial Banks mobilize financial resources from the saving public and provide them for industrial growth. In the process they can also influence the direction in which these resources are utilized. Banks are regarded as development agencies. In underdeveloped countries, banking facilities are limited. They are confined to specific areas and regions. They provide credit facilities to some sectors only. In India before nationalisation of major banks in 1969, banks neglected agriculture and small industry. Changes in the structure and functions are necessary to enable banks to perform development role in these economies.

In a modern economy, banks provide a variety of functions and services which are conducive to growth. They do much more than deposit banking. They undertake several financial services and introduce new instruments. They encourage entrepreneurs and also undertake entrepreneurial function. They also undertake social responsibilities. They are the agents necessary for economic

development. Banks play an important role in the development of a country. It is the growth of commercial banking in the 18th and 19th centuries that facilitated the occurrence of industrial revolution in Europe. Similarly, the economic progress in the present day developing economies largely depends upon the growth of sound banking system in these economies.

3. REGIONAL RURAL BANKS

In 1970, the Government of India announced 20 Point Economic Programme. One of the significant features of the programme was the liquidation of the rural indebtedness. Consequently, the Government of India thought it necessary to establish rural banks as subsidiaries of the public sector banks to cater to the credit needs of rural people. A Working Group constituted under the Chairmanship of Mr. M. Narasimham recommended on July 30, 1975 the establishment of RRBs. The first 5 RRBs were set up on October 2, 1975 by an Ordinance (which was replaced by the Regional Rural Banks Act of 1976).

The commercial banks are basically urban oriented and unable to provide credit at cheaper rates to the weaker sections of the rural people. In order to provide credit at cheaper rates and to protect the interests of the weaker sections of the rural population, the Regional Rural Banks came into existence in 1975. The Regional Rural Banks are relatively new banking institutions which were added to the Indian banking scene since October 1975. There are 196 Regional Rural Banks with a network of branches in the states of the Indian Union. These banks have been established by the Government of India in terms of the provisions of the Regional Rural Banks Act, 1976. The distinctive feature of a rural bank is that though it is a separate body corporate with perpetual succession and common seal, it is very closely linked with the commercial bank which has sponsored the proposal to establish it. The Central Government while establishing a rural bank at the request of the commercial bank specifies the local limits within which it shall operate. The rural bank may establish its branches or agencies at any place within the notified area.

In the beginning, the share-capital of every Rural Bank was one crore rupees, which was divided into one lakh shares of Rs. 100/- each. Fifty percent of the issued share capital was provided by the Central Government, fifteen percent by the concerned State Government and thirty five percent by the sponsoring bank. By Regional Rural Bank (Amendment) Act, 1987 the authorised capital of such rural banks was raised to five crore rupees and paid up capital to one crore rupees. The Board of Directors of a Rural Bank were empowered to increase the issued capital from time to time, after consultation with the Reserve Bank of India and

prior approval of the Central Government. The shares of the Rural Banks are deemed to be included in the securities enumerated under Section 20 of the Indian Trusts Act, 1882 and also approved securities for the purposes of the Banking Regulation Act, 1949.

A Rural Bank carries on the normal business of banking as defined in Section 5(b) of the Banking Regulation Act, 1949. It generally undertakes the business of granting loans and advances to small and marginal farmers and agricultural peasants, who may be individuals or groups and to co-operative societies which include marketing societies, agricultural processing societies, co-operative farming societies, for agricultural purposes or agricultural operations or for other relevant or allied purposes, and to artisans, small entrepreneurs and persons of small means, engaged in trade, commerce or industry or other productive activities within the notified area of the concerned Rural Bank. Every Rural Bank is managed by a Board of Directors, who act on business principles, but having due regard to the public interest. A Regional Rural Bank is guided by the directions issued by the Central Government regarding the matters of policy involving public interest.

Objectives and Functions : The RRBs perform the following functions:

(i) They provide credit facilities to the agricultural sector with particular emphasis on small and marginal farmers and agricultural labourers.

(ii) They promote the welfare of economically and socially backward sections of the population.

(iii) They help the rural artisans and small entrepreneurs in rural areas by providing credit facilities.

(iv) Alongwith the agriculture, they are expected to help small business units and self-employment schemes and thereby promote the alround development of village societies.

(v) They mobilize deposits of rural people.

(vi) They provide subsidiary services like commercial banks.

4. CO-OPERATIVE BANKS

Cooperation means voluntary association on the basis of equality and for some common purpose. The basic principle of cooperation is 'each for all and all for each'. In the words of H.Calvert, "Cooperation then is a from of organisation wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of their economic interest". Cooperative bank is an

institution established on the cooperative basis and dealing in ordinary banking business. Like other banks, the cooperative banks are funded by collecting funds through shares, deposits etc.

The co-operative banks are established under the Co-operative Societies Acts of the states concerned. The co-operative banks are basically rural oriented and function on the principles/ideas of co-operation. They have three tier set-up and sub-divided as follows –

(i) State Co-operative Banks

(ii) Central/District Co-operative Banks at District Level and

(iii) Primary Credit Societies at village level

(i) State Co-operative Banks : State cooperative banks are the apex institutions in the three-tier cooperative credit structure, operating at the state level. Every state has a state cooperative bank. State cooperative banks occupy a unique position in the cooperative credit structure.

(ii) Central/District Co-operative Banks at District Level : Central cooperative banks are in the middle of the three-tier cooperative credit structure. Central cooperative banks are of two types : (a) There can be cooperative banking unions whose membership is open only to cooperative societies. Such cooperative banking unions exist in Haryana, Punjab, Rajasthan, Orissa, and Kerala, (b) There can be mixed central cooperative banks whose membership is open to both individuals and cooperative societies. The central cooperative banks in the remaining states are of this type. The main function of the central cooperative banks is to provide loans to the primary cooperative societies. However, loans are also given to individuals and others.

(iii) Primary Credit Societies at village level : Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments. It serves as the last link between the ultimate borrowers, i.e. the rural people, on the one hand, and the higher agencies, i.e. Central cooperative bank, State cooperative bank, and the Reserve Bank of India, on the other hand.

A primary agricultural credit society may be started with 10 or more persons of a village. The membership fee is nominal so that even the poorest agriculturist can become a member. The members of the society have unlimited liability which means that each member undertakes full responsibility of the entire loss of

the society in case of its failure. The management of the society is under the control of an elected body.

The co-operative banks also perform the basic functions of banking and differ from the commercial banks as follows –

(a) The commercial banks are established under the central enactment viz. the Companies Act, 1956 or a separate Act passed by the Parliament, while the co-operative banks are established under the Co-operative Societies Acts of the States concerned.

(b) The co-operative banks have three tier set-up as stated above, while the commercial banks are organised on unitary basis.

(c) Only the State Co-operative banks have access to the Reserve Bank of India, whereas every commercial bank which is a scheduled bank is entitled to avail of the refinance facilities from the Reserve Bank of India.

(d) The co-operative banks function within a limited area / jurisdiction only viz. particular state or district or to a local area (in case of a society)., whereas the jurisdiction of commercial banks extends to other district, states and also other countries.

(e) The Reserve Bank of India has full / complete control over the commercial banks, whereas its control over co-operative banks is partial.

(f) Co-operative banks function on the principles / ideals of co-operation, while the commercial banks function on sound business principles and profit motive.

5. DEVELOPMENT BANKS

The banks, which aim to promote trade, commerce and finance and to develop the economy of our country may be divided into two categories namely:

(i) Industrial Development Banks, and

(ii) Land Development Banks.

(i) Industrial Development Banks : Industrial sector is playing vital role in the economy of any nation and hence the government takes all necessary steps by providing financial assistance through financial organisations for industrial

development. Industrial banks, also known as investment banks, mainly meet the medium-term and long-term financial needs of the industries. Such long-term needs cannot be met by the commercial banks which generally deal with short-term lending. The main functions of the industrial banks are : (a) They accept long-term deposits (b) They grant long-term loans to the industrialists to enable them to purchase land, construct factory building, purchase heavy machinery etc. (c) They help selling or even underwrite the debentures and shares of industrial firms. (d) They can also provide information regarding the general economic position of the economy.

Following are some of the notable institutions/ organisations of industrial finance -

(a) Industrial Development Bank of India

(b) Industrial Finance Corporation of India

(c) State Financial Corporation and

(d) Industrial Credit and Investment Corporation of India Limited

(a) Industrial Development Bank of India : The Industrial Development Bank of India is the apex bank, which provides industrial finance. It was established in July 1964 as a wholly owned subsidiary bank of the Reserve Bank of India. On 16th February 1976 it was delinked from the Reserve Bank of India and its entire share capital was transferred to the Central Government. Consequently, its role has been enlarged and has been conferred the status of principal financial organisation for coordinating the functions and activities of all India term lending institutions and also to some banks under the public sector. The IDBI provides direct finance to the large scale and medium industries. It also extends indirect financial assistance to the other industrial establishments as stated below -

(i) The IDBI refinances the industrial loans sanctioned by the State Financial Corporations, State Industrial Development Corporations, Commercial Banks, Co-operative Banks, Regional Rural Banks etc.

(ii) It provides financial assistance by re-discounting of bills and

(iii) It provides seed capital assistance granted to new entrepreneurs through the State Financial Corporations, State Industrial Development Corporations etc.

(b) Industrial Finance Corporation of India : The Industrial Finance Corporation of India is the first Industrial Development Bank in India. It was established in the year 1948 with the main objective to provide finance to the

newly established industries for the purpose of accommodation and fixed assets. It has been contributed 50 % by the Industrial Development Bank of India and 50 % by the Scheduled Banks. It raises its resources by issuing bonds in the market, borrowing from Industrial Development Bank of India, Central Government and other financial institutions and foreign credits.

(c) State Financial Corporation : The Industrial Finance Corporation provides financial assistance to large public limited companies and cooperative societies and does not cover the small and medium-sized industries. In order to meet the varied financial needs of small and medium sized industries, the Government of India passed the State Finance Corporations Act in 1951, which empowers the State governments to establish such Corporations in their states. The first State Financial Corporation was set up in Punjab in 1953. At present, there are 18 SFCs operating in the country. All of them except the Tamil Nadu Industrial Corporation were established under the State Financial Corporation Act, 1951. The Tamil Nadu Industrial Investment Corporation was set up as a joint stock company in 1949. The main objective of the State Financial Corporation is to promote the small and medium industrial units having the paid up capital and reserves not exceeding Rs. 1.00 crore. They provide financial assistance upto 60 years to the industrial units within the states concerned.

The Industrial Development Bank of India has made a significant contribution towards the share capital of the SFCs. Moreover, the SFCs depend upon the IDBI for refinance in respect of the term loans granted by them. Apart from the above, SFCs also resort to temporary borrowings from the Reserve Bank of India and borrowings from IDBI and by the sale of bonds.

Functions : The functions of the State Financial Corporations are summarized below –

(i) The SFCs have been established to provide long-term finance to small-scale and medium-sized industrial concerns organised as public or private companies, corporations, partnership or proprietary concerns.

(ii) The SFCs extend loans and advances to the industrial concerns repayable within a period of 20 years.

(iii) The SFCs guarantee loans raised by the industrial concerns in the market or from scheduled or cooperative banks and repayable within 20 years.

(iv) The SFCs subscribe to the debentures of the industrial concerns repayable within a period of 20 years.

(v) The SFCs guarantee loans raised by the industrial concerns from scheduled or cooperative banks and repayable within 20 years.

(vi) The SFCs underwrite the issue of stocks, shares, bonds and debentures by industrial concerns.

(d) Industrial Credit and Investment Corporation of India Limited : The Industrial Credit and Investment Corporation of India Limited was established as a Joint Stock Company in 1955. Its main objective was to chanellise the funds granted by the World Bank for industries in India, and also to make up a capital market in the country. Its entire share capital was held by commercial banks, insurance companies which were then in the private sector and were not nationalised, and individuals. After nationalisation of the main commercial banks and the insurance companies the major share capital of the Corporation fell in the hands of these nationalised institutions. IN 1991 the number of individual share holders has been increased by the recent public cum rights issue of equity capital. Now the individual share holders are increased to about four lakhs and their share holding proportion has thus increased to a worthwhile extent.

The Corporation mainly grants term lending to industry as a financial assistance to them. It has now undertaken to lease industrial equipments, asset credit and deferred payment, financing of sale of industrial equipment. Foreign currency loans also are given by it as it can raise funds in foreign currencies also. It is also playing a significant role in the development of the capital market. It undertakes underwriting, and making direct subscription to shares and debentures of companies. It helps the merchant bankers in raising resources in the capital market. It has been trying to avail funds from traditional resources also as well as from non-conventional resources.

(ii) Land Development Banks : (State Level Land Development Banks and Primary Land Development Banks) : The Land Development Banks are the co-operative societies/ institutions, which provide long term credit facilities in the agricultural sector. The main objective behind the establishment of the Land Development Banks is agricultural development. The structure of these banks is two tier i.e. i) State Level Land Development Banks and ii) Primary Land Development Banks. The central land development banks are located at state level, while the primary land development banks are located at the district and taluka level. In certain states, the structure of the Land Development Bank is unitary in case of which, there are Apex Land Development Banks, which operate directly through their branches at district level. E.g. Gujarat, Jammu & Kashmir. These banks raise their resources by floating debentures in the market which are

guaranteed by the State Governments and subscribed by the Central and State Governments.

(iii)Agricultural Finance Corporation Ltd. : It was set up as a Joint Stock Company in 1968 by the Indian Banks Association. Its main object is to help the commercial banks in financing the agricultural projects. There are about 37 banks, which include the State Bank of India and other nationalized banks are the shareholders of this corporation. It is now functioning as a Rural Development Consultancy Organisation. It has built up expertise in this field and is engaged in the formulation of projects and development plans at the instance of member banks, State Governments and the Central Government. It locates and identifies potential areas or projects for investment by banks, also assists the banks in conducting surveys of the potentials for investment, production and deposit mobilization with a view to select operational areas. It has started consultancy work abroad as well.

(iv) National Bank for Agriculture and Rural Development (NABARD): With the increasing role of institutional credit in the integrated rural development of the country, it was felt necessary for a single broad based organisation which would not only extend adequate financial assistance to the various credit institutions of the rural areas but also provide guidance in all the matters concerning the formulation and implementation of rural development programmes. So far all such functions have been performed by the Reserve Bank of India and the Agricultural Refinance and Development Corporation (ARDC). In 1981, the Committee to Review Arrangement for Institutional Credit for Agriculture and Rural Development (CRAFICARD), set up by the Reserve Bank of India, recommended the establishment of the National Bank for Agriculture and Rural Development (NABARD). The recommendation was approved by the government and consequently NABARD came into existence on July 12, 1982. (NABARD) is the apex development bank for agriculture and rural development. It was established on July 12, 1982 by merging the Agricultural Credit Department and Rural Planning and Credit Cell of the Reserve Bank of India, and the entire undertaking of Agricultural Refinance and Development Corporation.

The functions of the NABARD are three tier, namely –

(a) The credit functions

(b) The development functions, and

(c) The regulation functions

(a) Credit Functions : It provides through the banking system all kinds of productive and investment credit to agriculture, small scale industries, cottage and village industries, handicrafts, and other allied economic activities. It provides different types of refinance (i.e. short term, medium term and long term) to the eligible institutions, namely (i) State Co-operative Banks (ii)Regional Rural Banks, (iii)State Land Development Banks (excluding short term), (iv)Commercial banks (only long term) and other financial institutions approved by the Reserve Bank. NABARD has prescribed lower rates of interest on the refinance provided by it and the rates payable by the ultimate borrowers.

(b) Development Functions : NABARD coordinates the operations of rural credit agencies, develops expertise to deal with agricultural and rural problems, assists Government, Reserve Bank and other institutions in rural development efforts, acts as agent to Government and Reserve Bank in relevant areas. It provides facilities for training and research, assists the State Governments to enable them to contribute to the share capital of eligible institutions.

(c) Regulatory Functions : The Banking Regulation Act, 1949 empowers the NABARD to undertake inspection of Regional Rural Banks and Co-operative Banks(other than primary co-operative banks). If any such bank seeks permission of the Reserve Bank for opening branches etc., it will have to obtain the recommendation of NABARD.

In addition to the above, there are many other financial institutions viz. Industrial Reconstruction Bank of India, Life Insurance Corporation of India, Unit Trust of India, Export Import Bank of India (Exim Bank), National Housing Bank, Discount and Finance House of India Ltd., Small Industries Development Bank of India etc. etc.

Achievements of NABARD : NABARD is a single integrated organisation which looks after the credit requirements of all types of agricultural and rural development activities. It operates (a) as an apex institution dealing with all matters concerning policy, planning and operational aspects of rural credit, and (b) as an apex refinancing agency providing financial support to banks for increasing their credit facilities in the rural areas. NABARD has started performing its functions smoothly. Its performance in extending various types of financial assistance is as follows :

(i) **Short-term Credit :** It provides short-term credit facilities to state cooperative banks for financing seasonal agricultural operations,

marketing of crops, pisciculture activities ; production/procurement and marketing activities of weavers cooperatives, Production and marketing activities of industrial cooperatives, financing individual rural artisans through PACs, purchase and distribution of fertilizers, marketing activities etc.

(ii) **Medium-term Credit :** Medium term facilities are provided to St.CBs and RRBs for converting short-term loans into medium-term loans. During 2005-06, NABARD sanctioned total credit limit aggregating Rs. 13,099 crore as against Rs. 13,230 crore during 2004-05.

(iii) **Long-term Credit :** Long term loans are granted to State Governments.

(iv) **Schematic Lending :** Salient features of assistance provided by NABARD under its schematic lending operations are given below :

(a) Under various schematic lending operations, NABARD provides refinance assistance to four agencies, namely State Land Development Banks (now known as State Cooperative Agricultural and Development Banks), Scheduled Commercial Banks, Regional Rural Banks, and State Cooperative Banks.

(b) By the end of June 2002, NABARD disbursed Rs. 6590 crore for various schematic lending programmes to these agencies. Of this, the share of State Land Development Banks was the largest (54 %), followed by scheduled Commercial Banks (18 %), Regional Rural Banks (17 %) and State Cooperative Banks (11 %).

(c) Purpose-wise, farm mechanization operations accounted for the largest share of 28 %, followed by Integrated Rural Development Programme (IRDP) of 15.6 % (Rs. 611 crore), and minor irrigation projects, 13.4 % (Rs.525 crore).

(d) Regarding the regional pattern of distribution of assistance, Southern region accounted for the highest share in the total disbursement (30.9%), followed by the Northern region (22.7 %), the Central region (17.9%), and Western region (14.5%).

(v) **Assistance to Less Developed States :** NABARD, like ARDC, has continued the policy of promoting agricultural investment in the less developed and under-banked states i.e. Uttar Pradesh, Bihar, Madhya Pradesh, Rajasthan and Orissa. These states in the same order have been receiving the largest share of financial benefits from NABARD.

(vi) **Assistance to Non-Farm Sector :** NABARD also provides financial help to non-farm activities with a view to promote integrated rural development. Finance is provided for production and marketing activities of cooperative sugar mills, recognized cottage and small scale industries, handloom weavers' societies, industrial cooperative societies, rural artisans, members of the village level cooperatives, etc.

(vii) **Rehabilitation Programme :** NABARD started taking active part in organizing and strengthening the cooperative credit structure of the country. It has initiated a rehabilitation programme for financially and administratively weak Central and State Cooperative Banks. Ason June 30, 1986, 173 Central Cooperative Banks and 8 State Cooperative Banks were covered under this programme. NABARD also provides help in the rehabilitation work of State land development banks and Primary land development banks. State governments have been asked to take effective measures to ensure functional coordination between short-run and long-run lending by cooperatives, and NABARD has created a cell to monitor the implementation of this directive.

(viii) **Assistance to Research and Development Projects :** Every year, NABARD provides financial assistance to a number of bank from its Research and Development Fund for setting up or strengthening their Technical, Monitoring and Evaluation (TME) cell. It also sanctions funds for organizing research, conferences, seminars, etc. on subject having relevance to NABARD.

(ix) **Rural Infrastructure Development Fund (RIDF) :** The Union Budget 1995-96 proposed creation of Rural Infrastructure Fund in NABARD with a corpus of Rs. 2000 crore. All Indian Scheduled Commercial Banks contributed their shortfall in agricultural lending target of 189 % of net bank credit to the fund (except RRBs) with every successive budget, the Government continued RIDF designating as REDF-I, REDF-II and so on. The disbursements under REDF I to XI aggregated Rs. 31,337 crore as on March 31, 2006. In 2005 loans were sanctioned to 30,440 projects. Purposewise, the funds are used for construction, completion of irrigation projects, roads, bridges etc.

(x) **Kisan Credit Cards (KCC) :** It was introduced in 1998-99. KCCs are issued to farmers by commercial banks, cooperative banks and RRBs. These cards enable the farmers to obtain credit. The limit of Rs. 5000

was dispensed with. The loans disbursed under KCC scheme are insured (Rashtriya Krishi Bima Yojana) by the General Insurance Corporation. This KCC scheme is linked with self-help Group Lending. NABARD directed RRBs and cooperative banks to issue KCCs liberally. Loans extended through self help groups and Non-Governmental Organisations will be treated as Micro Credit. It will be included in advances to priority sectors. Since 1998, 59.09 million KCC's were issued till the end of March 2001. It is heartening to note a majority of self-help groups are formed by women.

(v) Exchange Banks: Exchange Banks are those banks which deal with foreign exchange and have specialized in financing foreign trade. These banks are foreign banks and have their head offices located outside the country. Although the main business of these banks is financing of foreign trade, they also perform normal commercial banking functions and thus compete with local commercial banks.

The main function of exchange banks is to finance foreign trade. There are two aspects of financing foreign trade : (a) financing exports, and (b) financing imports.

(a) **Financing of exports :** The procedure adopted by exchange banks for financing export trade is as follows : The Indian exporter draws a bill of exchange on the foreign importer. This bill is drawn for a period of 90 days and is called D.A. bill (Documents on Acceptance Bill). This bill, alongwith the shipping papers, is then sent to the foreign importer for acceptance through some exchange bank. After its acceptance by the foreign importer, the bill is returned to the exporter who can either get it discounted with the exchange bank or keep it with him and get the payment within three months.

(b) **Financing of imports :** The imports to India are financed through D.P. bills (Documents on Payment bills) drawn by the foreign exporters on Indian Importers. The exchange bank presents the D.P. bill to the Indian Importer for getting his acceptance. The shipping documents are given to the Indian importer only after the full payment is made or if the importer executes a trust deed in favour of the exchange bank under which exchange bank remains the owner of the goods till the payment of goods is made.

Indian Banks Abroad : Indian banks also operate as foreign banks in other countries. As on 31st March 2006, 18 Indian banks had overseas operations spread over 47 countries with a network of 112 branches (including offshore units, 6 joint ventures, 185 subsidiaries and 35 representative offices). These branches are located at the major international centers like London, Singapore, Bahrain, and Paris. The largest concentration of the Indian bank branches is in the U.K., U.S.A., Fiji, Kenya, United Arab Emirates (U.A.E.), Hong Kong, Mauritius and Singapore. Bankwise the largest number of branches are of Bank of Baroda, followed by the State Bank of India and Bank of India. These branches specialize in financing of foreign trade and international banking. There are 35 representative offices of India banks abroad. The number of wholly owned subsidiaries and joint ventures of Indian banks stood at 18 and 6 respectively.

(C) TYPES OF DEPOSIT ACCOUNTS

The primary function of banks is borrowing and lending. Banks borrow money from the public by accepting various kinds of deposits at lower rate of interest and lend the same funds to the industrialists, businessmen, traders and other members of the public by sanctioning loans and advances at higher rates of interest and thereby earn profits. The deposit accounts, accepted by the banks may be broadly categorized under the following heads -

1. Savings Bank Account
2. Current Deposit Account
3. Fixed Deposit Account and
4. Recurring Deposit Accounts

1. Savings Bank Account : Savings Bank Accounts are opened in the commercial and other scheduled banks by the people of lower income group. Any individual/resident with proper identity through the introduction of one of the customers of the bank can open and operate savings bank account with or without cheque book. There are certain restrictions with regard to maintenance of minimum and maximum balance and withdrawals in respect of the savings bank account. Banks offer small/meager rate of interest on the savings bank accounts.

2. Current Deposit Account : Current deposit accounts or Current Accounts are also known as "Demand Deposits". Current Accounts are generally opened by the persons of higher income, namely industrialists, businessmen, trusts,

partnership firms, companies, educational institutions etc. Current account means "money withdrawable without any notice". There is no any restriction with regard to number of withdrawals. Generally, banks may or may not pay interest on current account deposits. The rate of interest if paid, is very meager and less than the rate of interest paid on savings bank deposits. The customer must maintain a minimum balance of Rs. 5,000/- in respect of current deposit accounts (the minimum balance requirement may differ from bank to bank). The customer is issued a cheque book containing 50 to 100 leaves. The bank may extend overdraft facility to the current account holders.

3. Fixed Deposit Account : The banker may accept deposit of a particular sum of money from the customer for a particular period viz. for few days, few months or few years. The amount of deposit alongwith interest will be repaid to the fixed deposit holder only after the expiry of the stipulate period. If the deposit holder needs money before the expiry of the fixed/stipulated period, he may be allowed to withdraw 80 to 85 % of the deposit amount as loan at higher rate of interest (suppose, the bank pays 8 % of interest on the fixed deposit, it charges 9 % to 10 % interest from the customer, while sanctioning the loan on fixed deposit accounts). The rate of interest varies depending upon the term/ period of the fixed deposit. Therefore, fixed deposits are also known as "term deposits". The rate of interest on term deposits is higher, when compared to the savings bank account deposits.

4. Recurring Deposit Accounts : Banks invite the customers to open recurring deposit accounts for a specific/particular period viz. few months or few years by accepting fixed sum of money every month. For instance, a customer may open recurring deposit account for five years by depositing one hundred rupees every month. He will be paid the total amount with interest on expiry of 5 years/60 months. If the customer needs money in the middle, he can take loan upto 80 % or 85 % of the balance at his credit for higher rate of interest.

In addition to the above deposit accounts, the modern commercial banks introduced variety of deposits providing different kinds of benefits. For instance, Abhaya Savings Accounts providing accident insurance coverage by Andhra Bank, Yodha Shakti Shrama Yojana by the Bank of Baroda. It is a kind of recurring deposit account in respect of which any amount without any minimum or maximum limit is deposited every month and total amount with interest will be paid to the deposit holder on expiry of the stipulated period.

LECTURE - II
BANKER AND CUSTOMER

(RELATIONSHIP BETWEEN BANKER AND CUSTOMER)

This lecture covers –

1. *Banker : Meaning and Definition*
2. *Customer : Meaning and Definition*
3. *Relation between Banker and Customer*

(A) General Relationship

- *(i) Debtor and Creditor Relationship*
- *(ii) Trustee and Beneficiary Relationship and*
- *(iii) Agent and Principal Relationship.*

(B) Special Relationship or Banker's Rights

- *(1) Right of Lien*
- *(2) Right of Set-off and*
- *(3) Right of Appropriation of Payments or (Rule in Clayton's case.)*
- *(4) Banker's right to claim incidental charges*
- *(5) Banker's right to charge interest.*

(C) Obligations of the Banker

- *(1) Obligation to honour cheques and liability for wrongful dishonour*
- *(2) Vicarious liability of a Banker for the fraud committed by his servants*
- *(3) Garnishee Order*
- *(4) Secrecy of Customer's Account*
- *(5) Banker's obligation for Articles deposited with the bank and valuables kept in safe deposit vaults.*
- *(6) Duty not to close customer's account without his consent.*

1. BANKER : MEANING AND DEFINITION

The expression 'Banking' in the simple sense means 'carrying on business with money'. The term 'Bank' denotes "any person or firm or company, which transacts banking business". A bank is an institution which deals with money

and credit. It accepts deposits from the public, makes the funds available to those who need them, and helps in the remittance of money from one place to another.

There is no satisfactory definition, since it is very difficult to define the term 'Banking' or 'Banker'. However, many attempts were made to define the term. Following are some of the prominent definitions :

(i) General Definition : "A bank is what a bank does". It implies that the nature of a bank can be better understood by studying the functions performed by a bank. Among all definitions, this definition is the simplest.

(ii) Crowther : According to Crowther, a bank "collects money from those who have it to spare or who are saving it out of their incomes, and it lends this money to those who require it".

(iii) Kinley : In the words of Kinley, "A bank is an establishment which makes to individuals such advances of money as may be required and safely made, and to which individuals entrust money when not required by them for use."

(iv) Negotiable Instruments Act, 1881 : According to section 3 of the Negotiable Instruments Act, 1881, "Banker includes a person, corporation or company acting as a banker". This definition is not satisfactory.

(v) Hulsbury : Hulsbury has defined banker as "An individual, partnership or corporation, whose sole predominating business is banking, that is that receipt of money on current or deposit account and the payment of cheques drawn by and the collection of cheques paid in by a customer. (Halsbury's Laws of England 4th Ed. Vol 3, p.31)

(vi) American Definition : The earliest successful attempt was made by legislators in the United States of America, who enacted the following definition :

By "banking" we mean the business of dealing in credits and by a 'bank' we include every person, firm or company having a place of business where credits are opened by the deposit or collection of money or currency, subject to be paid or remitted on draft, cheque or order, or money is advanced or loaned on stocks, bonds, bullion, bills of exchange or promissory notes, or where stocks, bonds, bullion, bills of exchange or promissory notes are received for discount or sale. (Indian Finance and Banking, by Findlay Shirras, 2nd impression, p.336)

This definition is not satisfactory on the ground that, it is more like a description rather than a definition.

In England, there is no satisfactory definition of the term banking. However, some definitions given by the leading writers are given below –

(vii) Sir Hubert L. Hart : He says that "A banker is one, who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts."

This definition is based upon the dicta given in a number of decisions.

(viii) Sir John Paget : According to Sir John Paget, "No person or body, corporate or otherwise, can be a banker who does not (a) take deposit accounts, (b) take current accounts, (c) issue and pay cheques, and (d) collect cheques, crossed and uncrossed, for his customers".

This definition points out the four essential functions of the banking business. Sir John Paget also lays emphasis on the performance of the above functions in a regular and recognized manner. According to him, "one claiming to be a banker must profess himself to be one and the public must accept him as such; his main business must be that of banking from which, generally, he should be able to earn his living". The above-mentioned functions are considered as the essential functions of a banker but this definition does not include the other functions which are now being performed by modern bankers.

The above two definitions given by English writers also are not satisfactory.

(ix) The Banking Regulation Act, 1949 : Section 5 (b) of the Act defines the term 'Banking' as "accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise."

Ingredients or constituents of the definition :

(a) The very purpose of the acceptance of the deposits is for the purpose of lending or investment.

(b) The acceptance of deposits is from the public.

(c) These deposits can be withdrawable through cheques, drafts, orders or otherwise.

This definition covers the most important functions viz. the borrowing (acceptance of deposits of money from the public) and lending (sanction/payment of loans and advances to the public viz. individuals, traders, industrialists etc.) and hence it is regarded workable and is accepted.

2. CUSTOMER : MEANING AND DEFINITION

The expression 'Customer' in the simple sense means, one who transacts himself with the bank subject to certain terms and conditions as imposed by the Banker. In other words, a person, who maintains an account with the bank may be regarded as customer.

The term 'customer of a bank' has not been defined in the Banking Regulation Act, 1949 or any other Act. By the term it is generally understood or mean an account holder of a bank. But this general understanding of the term has been qualified by banking experts and judgements of law courts. Hence, there is no satisfactory definition for the term 'customer'. However, some attempts were made to define the term 'customer' as stated below –

(i) Sir John Paget : Sir John Paget defines 'Customer' as "to constitute a customer, there must be some reasonable course or habit of dealing in the nature of regular banking business". According to him, mere opening an account with bank would not confer the status of customer. There must be a regular course of dealing with the bank, to be designated as a customer. However, this view was subject to criticism on the ground that, this definition puts emphasis on duration of dealing with a bank as an account holder. It is not correct to say that there must be regular course of dealing with Banker.

Duration Theory : Sir John Paget is an exponent of duration theory. He mentions in his theory the importance of having frequent transactions with the bank. But this theory was rejected in the case of *Ladbroke vs. Todd (1914)* by Baihache, J. who observed that relationship between banker and customer begins as soon as the first cheque is paid in and accepted for collection. Mr. Justice Baihache in deciding the case *Ladbroke vs. Todd,* did not accept the duration theory of Sir John Paget and observed thus : "The relation of banker and customer begins as soon as the cheque is paid in and accepted for collection and not merely when it is paid."

Honour of cheques upto the amount standing to his credit is a custom in the sense of the statute irrespective of whether his connection is of long or short standing. This is the present law. This view was confirmed by the Kerala High Court in the Case of Central Bank of India Ltd., Bombay V. Gopinathan Nair and others. From the decisions it is clear that frequency of transactions is not a necessary condition to make a person customer. But the transaction must be of such nature, it is likely to lead to frequency of transactions in the near future.

Hence a person becomes customer when he satisfies the following conditions :

(a) He must have an account with the banker.

(b) The dealings between him and the banker must be in the nature of regular banking business. Casual transactions such as depositing valuables for safe custody are not of banking nature. Dealings of banking nature means borrowing money by way of accepting deposits, granting loans and advances, issuing and honouring cheques, collection of cheques etc.

(ii) Dr. Hart's Definition : According to Dr. Hart, "a customer is one, who has an account with a banker or for whom a banker habitually undertakes to act as bank". According to him, a singie transaction is sufficient to constitute a customer. Therefore, to constitute customer, the following two conditions are to be satisfied :

(a) He must open an account with the Bank to have a dealing with the Bank;

(b) The nature of such dealing must be in form of a banking transaction.

The Kerala High Court in *Central Bank of India Ltd, Bombay vs. Gopinathan Nair & others, AIR 1979 Ker. 74*, has laid down :

"Broadly speaking, a customer is a person who has the habit of resorting to the same place or person to do business. So far as banking transactions are concerned he is a person whose money has been accepted on the footing that the banker will honour upto the amount standing to his credit, irrespective of his connection being of short or long standing."

In this very sense the statement in the question has been made that "to constitute a customer there must be some recognizable course or habit of dealing in the nature a regular banking business."

A customer of a bank need not necessarily be a person/individual. An individual, a group of individuals (joint account), a firm, a company (private or public ltd.) or Government can become, a customer of a bank by opening an account with the banker.

3. RELATION BETWEEN BANKER AND CUSTOMER

The institution of Banking has great significance and is playing a predominant role in the economy of every country in the world. There are various

banks with variety of functions, commercial or otherwise. Commercial Banks are those which carry on banking business to earn profits. They borrow from the public in the form of various deposits at lower rates of interest and lend the same to the public, traders and Industrialists etc. at higher rates of interest and thereby earn profits. The relationship between the banker and customer can be studied with reference to the following heads -

(A) General Relationship

(i) Debtor and Creditor

(ii) Trustee and Beneficiary and

(iii) Agent and Principal.

(B) Special Relationship or Banker's Rights

(i) Right of Lien

(ii) Right of Set-off and

(iii) Right of Appropriation of Payments or
Rule in Clayton's case.

(iv) Banker's right to claim incidental charges

(v) Banker's right to charge interest.

(C) Obligations of the Banker

(i) Obligation to honour cheques and liability for wrongful dishonour

(ii) Vicarious liability of a Banker for the fraud committed by his servants

(iii) Garnishee Order

(iv) Secrecy of Customer's Account

(v) Banker's obligation for Articles deposited with the bank and valuables kept in safe deposit vaults.

(vi) Duty not to close customer's account without his consent.

(All the above topics are very important from the Examination point of view. Questions may be asked in general on General Relationship or Debtor and Creditor in particular; Special Relationship in General or Banker's Lien (Right of Lien) or the Appropriation of Payments (Set-off : short notes) in particular; and Bankers' Obligations in general or obligation to honour cheques and liability for wrongful dishonour (Garnishee Order, Secrecy of Customer's Account : Short Notes) in particular.)

(A) GENERAL RELATIONSHIP

The relationship between Banker and Customer in general (General Relationship) may be explained with reference to the following heads :

1. Debtor and Creditor Relationship
2. Trustee and Beneficiary Relationship and
3. Agent and Principal Relationship

1. DEBTOR AND CREDITOR RELATIONSHIP

According to Sir John Paget, the general relationship between banker and customer is primarily that of a debtor and a creditor. The relationship is purely contractual since both of them will have rights and obligations against each other. The primary function of a Banker is to borrow money from the public (customers) by way of different kinds of deposits. Banker assumes the position of a debtor by accepting such deposits. Banker's position as debtor continues so long as the customer maintains credit balance. The Banker, like a debtor, is under an obligation to repay (as and when or on expiry of a stipulated period in case of RD/FD accounts) the customer on demand. When the Banker allows/permits his customer to overdraw, the position is reversed (i.e. in case of overdraft, the banker becomes creditor). The other primary function of banker is lending. The banker lends his customers, by allowing O.D. (Overdraft), Cash Credits, Loans etc. Then, the Banker remains as creditor till the customer clears of his loan. The Law of Limitation is also applicable to the Banker and Customer in respect of their positions as the debtor and the creditor. The limitation period is three years.

According to Art. 22 of the Limitation Act, 1963 the period of limitation to the deposit is three years which starts from the date of demand by the customer and not from the date of deposit. So in case of Banker's debt, the period of limitation (three years) begins from the date of demand and for a fixed deposit, it applies only from the date of maturity. But, in case of ordinary commercial debts the period of limitation starts from the date of the debt. So this is also a peculiar feature of banker and customer relationship.

In case of an ordinary commercial debt, the debtor repays on a specified date as per terms of the contract. But, in case of a deposit with the Banker, the debtor (Banker) need not repay on his own accord, until and unless the amount is demanded. The relevant case on this point is –

Joachinson vs.Swiss Banking Corporation, (1921 3 K.B. 110): It was held in this case that a banker's debt (deposit by customer) is not to be repayable without previous demand.

Further, customers position is that of an unsecured creditor since he has no charge over the assets of the bank. However, the banker as creditor(when a loan was sanctioned) exercises charge over the assets of the customer.

Velji Lakshmsey & Co. vs. Dr. Banaji & Co., (1955) 25 COMP. CAS. 395: In this case the Bombay High Court held that the customer, depositor/ creditor cannot be treated as a preferential creditor in case, the bank is wound up.

The relationship between banker and customer has been defined as that of debtor and creditor is on the basis of the decision given in the leading case of *Foley vs. Hill, (1848) 2 H.L.C. 28*

Bhashyam and Adiga's Negotiable Instruments Act states – The relationship of a banker and customer is that of a creditor and debtor with the superadded obligation of honouring customer's orders on the funds in his hands.

Lord Brougham said – This trade of a banker is to receive money and use it as if it were his own he becoming debtor to the person who has lent or deposited with him the money to use as his own. In this connection the banker is not an agent, or factor, but he is debtor.

Therefore, it is to be noted that the following points are to be borne in mind with regard to the Banker and Customer as that of the debtor and creditor –

(i) The banker who accepts deposits is a debtor and the customer, who deposits is a creditor. In respect of loans and advances sanctioned by a bank, the position is vice versa.

(ii) The banker as a debtor does not approach the customer (creditor),but the customer (as a creditor) on the other hand approaches the banker (debtor) to deposit his money with the banker and hence, the banker is called "privileged debtor".

(iii) The customer as creditor does not insist on the debtor banker, any securities or sureties at the time of depositing the money with the banker.

2. TRUSTEE AND BENEFICIARY RELATIONSHIP

The functions of bankers are broadly classified under three heads namely :

(i) Primary functions i.e. borrowing and lending (refer creditor and debtor relationship).

(ii) Subsidiary functions, which includes agency services by banker (refer relationship of Principal and Agent) ; and

(iii) General utility services (maintainence of safe deposit vaults) : It refers the banker's position as a trustee.

A trustee is a person, who holds money or certain property and performs certain functions for the benefit of some other person called 'Beneficiary'. E.g. A transfers certain property to B upon a trust for the benefit of C. Here, A is called "Settler of Trust Owner". B is called "Trustee" and C is called "Beneficiary". Generally, a banker is a debtor of his customer in respect of deposits made by the customer, but in certain circumstances he acts as trustee also. Many banks have separate departments for discharging the trusteeship functions and such banks are named as the Trustee when trusts are created. Similarly, banker maintains safe deposit vaults etc., for the benefit of his customers. When the customer deposits securities or other valuables with the banker for safe custody, the banker is said to be a trustee. In the event of winding up of the bank, the creditors will not have any charge over the things/properties for which the banker acts as a trustee. (In case the bank is wound up, there is no assurance/security for customer's deposits. But, the documents or valuables deposited in safe deposit vault are safe under the trusteeship of Banker. However, there are certain exceptions to this rule).

3. AGENT AND PRINCIPAL RELATIONSHIP

When a person appoints another to act on his behalf with a third party, it is called 'Agency'. The person who appoints is called 'Principal'. The other person, who is appointed is called 'Agent'. The contract between them (i.e. Principal and Agent) is called 'Contract of Agency'. Agency is the legal relationship between an agent and Principal, to bring the principal into legal relationship with the third party. Example – 'A' appoints 'B' to purchase some property on his behalf. Here 'A' is principal and 'B' is Agent. The relationship between 'A' and 'B' is called Agency.

When a banker buys or sells securities on behalf of his customer, he performs an agency function. Similarly, when he collects cheques, dividends, bills or promissory notes on his customer's behalf, he acts as his agent. Besides, he may also act in various other agency capacities, for example, as a trustee, attorney, executor, correspondent or a representative.

A banker acts as an agent of his customer by rendering variety of agency services. Under the standing instructions of his customer, he purchases and sells assets and securities on behalf of his customer. He collects cheques, discounts bills of exchange, pays telephone/electricity bills. His agency services between exporter and importer contribute a lot for the promotion of foreign trade.

(B) SPECIAL RELATIONSHIP
OR
BANKER'S RIGHTS

The special relationship between banker and customer refer to certain rights of the banker as stated below –

1. Right of Lien
2. Right of Set-off and
3. Right of Appropriation of Payments or the Rule in Clayton's case.
4. Banker's right to claim incidental charges
5. Banker's right to charge interest.

1. RIGHT OF LIEN OR BANKER'S LIEN
(RIGHT OF GENERAL LIEN)
1. RIGHT OF LIEN

Lien : Meaning : Banker's right of lien is an important special feature of banker-customer relationship. The term 'lien' means "the right of a creditor to retain in his possession the goods and securities owned by the debtor until the debt has been discharged, but not the right to sell". In simple, lien means right to retain the goods or securities till the debt is cleared.

Kinds of Lien : Lien is of two kinds namely –

(i) Particular or Special Lien; and

(ii) General Lien.

(i) Particular Lien : A particular lien gives the right to retain possession only of goods in respect of which the charges or dues have arisen. Eg. – A tailor's right to retain the clothes till the stitching charges are paid.

(ii) General Lien : A General Lien is one, which gives right to retain possession until the whole balance of the account is paid. It extends not only towards goods pledged as security but also in respect of others. A Banker exercises/ possesses the right of 'General Lien'.

Banker's Right of General Lien : It confers on Banker (as a creditor) right to retain the goods and other securities owned by the debtor until the debt due from him, is repaid. For instance, when a bank sanctions loan to a customer against a particular security. At the time of repayment/to clear off the loan, the security pledged/mortgaged is not sufficient to meet the liability, the banker may proceed (exercise lien) against other securities (movable or immovable) pertaining to the customer (debtor). Where as a particular lien confers right over a particular debt only. The general lien is applicable to all debts due from debtor to the creditor.

Section 171 of the Indian Contract Act, 1872 confers on Banker, the right of general lien. The banker can exercise his right of lien on all goods and securities entrusted to him in the capacity as a banker. The Banker cannot exercise his right of lien in respect of :

(i) the goods and securities entrusted to him as a trustee or an agent ; and

(ii) the goods and securities entrusted to him for some specific purpose.

Banker's lien : An Implied Pledge : If goods are delivered as security by one person to another, it is called 'Pledge'. Eg. – If a farmer delivers 100 bags of paddy or wheat for securing a loan from the bank, it is called 'Pledge'. The former is pledger and the banker is pledgee. In pledge, the pledgee (creditor) can exercise the right of sale. With the right of lien, the banker can sell the goods and securities in case of default by the customer. However, he cannot sell the title deeds of an immovable property.

Therefore, the Delhi High Court in *Vijay Kumar vs. Jullunder Body Builders & Others, (1983) 54 COMP. CAS. 125*, the banker's lien has judicially been defined as an Implied Pledge.

Thus, Lord Campbell in – *Brandao vs. Barnett, (1846)* - held that banker's lien is an implied pledge.

Exceptions to the General lien : The Banker cannot exercise the right of general lien in the following cases :

(i) Safe custody deposits : When the customer deposits with the banker, valuables, securities, documents etc. for safe custody, the right of General Lien cannot be exercised over them.

(ii) Documents deposited for Special Purpose.

(iii) When the customer, negligently or mistakenly left the securities with the banker.

(iv) When the right of general lien becomes particular lien.

2. RIGHT OF SET-OFF
(BANKER'S RIGHT TO SET-OFF : COMBINING OF ACCOUNTS)

The expression 'Set-off' means "Combining two accounts of the same customer". It is a mutual adjustment/arrangement between the banker(as creditor) and customer(as debtor) in respect of payments due to the creditor. Set off may aptly be described as the right of a Banker to appropriate the credit balance in one account of the customer towards sum due to him by the customer in another account in order to arrive at the net sum due. It is a statutory right, which a banker is entitled to exercise in order to combine two accounts in the name of the same customer to recover the debts due by the customer(debtor). The banker adjusts the debit balance in one account with the credit balance in another account. For instance, one of his customer's accounts shows debit balance i.e. overdraft of Rs. 10,000/- and another account shows a credit balance of Rs. 5,000/-. Then, the banker can adjust the credit balance of Rs. 5,000/- against the debit balance by combining the two accounts and can claim the remaining amount of Rs. 5,000/- only from the customer.

Conditions : The banker can exercise the right of set-off subject to the following conditions :

(i) The accounts must be in the same name of the customer and in the same right/capacity.

(ii) The right is in respect of debts due only ; not in respect of future debts.

(iii) The amount of debts must be certain and undisputed.

(iv) There should not be any agreement express or implied to the contrary.

(v) The right cannot be exercised after the Garnishee Order passed by the court.

Automatic Right of Set-off : Banker's right to set-off arises automatically under the following circumstances –

(i) On the death, insanity or insolvency of the customer.

(ii) On the insolvency of the partner of the firm or on the winding up of a company.

(iii) On the receipt of Garnishee Order.

(iv) On receiving notice of assignment of a customer's credit balance, and

(v) On receiving notice of second mortgage over the security charged to the banker.

It is generally believed that a banker could combine his customer's accounts unless there is an agreement contrary to that effect. This view was laid down, basing on the decision in –

Garnett vs. Mc. Kervan (1872) 27 LT 560 : In this case, the plaintiff had a dormant overdraft with one branch of a bank and a few years after he had stopped business with the branch, he opened a new account with another branch of the same bank, where his credit balance just exceeded the amount of the dormant debit balance referred to above. The amount required for the clearing of the overdraft with the first branch was transferred from his account with the second branch, which led to the dishonour of the customer's cheques drawn against his credit balance. The court's decision was in favour of the bank, as it was held that there was no special contract or usage proved to keep the accounts separate and that, while it might be proper and considerable to give notice to a customer of intention to combine accounts, there was no legal obligation on a bank to do so arising either from the express contract or course of dealings.

Halesowen Presswork & Assemblies Ltd v. Westminster Bank Ltd (1970 All E R. 33) : In this case, the court held that the bank is not entitled to combine two accounts if there was an arrangement with its customer at the time of opening the accounts to keep the accounts separately for a period unless the Bank had given notice to determine the arrangement by reason of special circumstances, the Bank having taken no steps to determine it.

3. RIGHT OF APPROPRIATION OF PAYMENTS (THE RULE IN CLAYTON'S CASE)

Meaning : The expression 'Appropriation of payments' means " adjusting the payment towards the debts". When a debtor owes several distinct debts to a creditor, and makes a payment not sufficient to clear/discharge all the debts, the question, that arises is : against which debt/debts the payment is to be adjusted/ appropriated ? Similarly, when the customer takes more than one loan, he owes to the banker different debts. Later, the customer may make payment, which is not adequate to clear all such distinct debts. Here, also the question of appropriation arises.

To answer this question, four rules were laid down in the Clayton's case. Hence, it came to be known as 'The Rule in Clayton's Case'. These rules are embodied in Sections 59 to 61 of the Indian Contract Act, 1872, as follows :

(i) When the debtor intimates, against what debt/debts (in full or in part) the payment is to be appropriated/adjusted, the creditor has to adjust/ appropriate accordingly (Sec. 59).

(ii) When the debtor (while making payment) does not indicate as to appropriation, the circumstance so implies that the payment is to be appropriated against a particular debt (implied appropriation). Eg. The payment may imply appropriation towards a debt which is about to be barred by limitation period.

(iii) When the debtor does not indicate as to appropriation, the creditor has a discretion to appropriate the payment against any debt including time barred, but not disputed one (Sec. 60).

(iv) Where neither of the parties appropriates, the payment shall be applied to discharge the debts including time barred ones in chronological order i.e. in order of time. If the debts are of equal standing, the payment shall be appropriated proportionately.

Question may arise whether the payment made by the debtor is to be adjusted first towards the interest or the principal in the absence of agreement to that effect ?

IN M/s. Kharavela Industries Pvt Ltd vs. Orissa State Financial Corporation & others : It was held that in the case of a debt due with interest, any payment made by the debtor should be adjusted first towards satisfaction of interest and thereafter towards the principal unless there is an agreement, to the contrary.

The Rule in Clayton's Case : The rule in Clayton's case is of great importance to the Bankers. The above four rules were laid down in the case of *Devaynes Vs. Noble (1816) 1 Meriavale 530, 535* (popularly known as 'Clayton's Case'). Hence, the above rules as to the appropriation of payment, came to be known as 'The Rule in Clayton's Case'.

Facts of the case : A firm of Bankers Devaynes, Daives, Noble & Co. had five partners. Devaynes, a senior partner died. The surviving partners continued the business. After one year, the firm became bankrupt and the creditors claimed against the estate of the deceased partner. N.Clayton, a creditor (customer) continued to deal with the firm even after the death of Devaynes. Clayton had a credit balance on the death of partner. Later, he withdrew in excess of the balance and also paid in, so as to arrive at credit balance. Mr. Clayton claimed that the

payments in, should be appropriated against the withdrawals so as to leave the credit balance intact at the time of partner's death. The court rejected his contention and denied the claim and laid down the above rules.

Thus, in case of death, retirement or insolvency of a partner, the existing debt (due from the firm) is adjusted by making subsequent credit made in the account. Then the banker has no right to claim such debt from the assets of the deceased/retired partner.

4. BANKER'S RIGHT TO CLAIM INCIDENTAL CHARGES

Every customer is expected/supposed to maintain a minimum balance with his account. If he fails to do so, the banker may impose/collect certain incidental charges for the purpose. Similarly, the banker may collect charges for issuing the statement of account of the customer's account.

5. BANKER'S RIGHT TO CHARGE INTEREST

If the banker has given a loan to the customer, as a lender the banker has a right to debit the interest to the customer's account. It is an implied right of the banker to charge interest for his loans, unless there is a contract to the contrary to this right. He is also entitled to collect the compound interest on the amount due to him at half yearly rests.

(C) OBLIGATIONS OF THE BANKER

The obligations or duties of a banker may be explained under the following heads:

1. Obligation to honour cheques
2. Vicarious liability of a Banker for the fraud committed by his servants
3. Garnishee Order
4. Obligation or duty to maintain Secrecy of Customer's Account
5. Banker's obligation for Articles deposited with the bank and valuables kept in safe deposit vaults.
6. Duty, not to close customer's account without his consent.

1. Obligation to Honour Cheques

It is one of the implied terms of the contract between a banker and a customer to honour cheques drawn by the customer subject to fulfillment of certain conditions under section 31 of the Negotiable Instruments Act, 1881. The Banker

is under statutory obligation to honour his customer's cheques, provided the following conditions are satisfied :

(i) There must be sufficient funds (credit balance) or within the permissible limit of overdraft.

(ii) The funds must be properly applicable to the payment of cheque. (Eg. The customer may have two accounts : one showing more credit balance and the other showing less credit balance. He cannot present a cheque for higher amount against his account showing less credit balance, although his other account shows sufficient credit balance).

(iii) The banker must be duly required to pay. This means the cheque must be presented within a reasonable time i.e. within 6 months. After 6 months, it becomes stale and cannot be honoured. Similarly post-dated (i.e. cheque with future date) cheque cannot be honoured. The customer shall present post dated cheque on or after the date of cheque and

(iv) The customer shall not be disqualified by law or order of the court (Garnishee Order) to draw the amount from his bank account.

The banker is liable for wrongful dishonour.

Liability of Banker for Wrongful Dishonour : A banker has a statutory obligation to honour his customer's cheques provided, the conditions under Sec. 10 of the Negotiable Instruments Act, are satisfied. (P.S. : This topic 'Banker's obligation to honour customer's cheques also appears in Negotiable Instruments Act). According to Section 31 of the Negotiable Instruments Act, 1881, the Banker is liable to compensate the drawer for loss or damage caused by such wrongful dishonour. Section 31 funs as follows –

"The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque must pay the cheque when duly required to do so and, in default of such payment, must compensate the drawer for any loss or damage caused by such default."

If there are sufficient funds to meet the cheque and the same is dishonoured by a bank, it can be held liable for the wrongful dishonour of the cheque and required to pay compensation for the damage caused thereby. It may be noted that the banker's liability is towards the payee or the holder of the cheque. The banker has a contractual relationship with the customer only, having a duty to

honour his cheques, and, therefore, only a customer i.e. the drawer can bring an action against the bank for the wrongful dishonour of the cheque.

The duty/obligation of a banker to honour his customer's cheque is supported in –

Fleming vs. Bank of Newzealand (1900 A.C. 577) : In this case, it was held that the duty of a banker to pay the cheques of his customer, who keeps a current account arises out of two implied stipulations between the parties. The first is that the banker will repay, what he borrows from his customer provided the latter makes a proper written demand for repayment at the current bank branch. The other is, that the banker will not injure his customer's credit by refusing to pay his cheques except on reasonable and proper grounds.

Assessment of Damages : While assessing/computing damages payable as a consequence of wrongful dishonour, the following factors/points are to be taken into consideration.

(i) Monetary loss caused to the drawer/payee and

(ii) Loss of credit and reputation.

The expression 'wrongful dishonour of a cheque means failure to make payment against the cheque by mistake or negligence on the part of the Banker or its employee'. Eg. An amount deposited and collected had not been credited to customer's account in time. Consequently cheques issued by such customer have been dishonoured for lack of funds. Or dishonour may take place, when the banker gives wrong debit to such customer's account instead of another by mistake.

The terms 'loss or damage' under sec. 31 denotes : (i) monetary loss suffered by the customer ; and (ii) loss of credit or reputation. In other words, the Banker is liable to compensate not only actual monetary loss, but also the loss of reputation suffered by the customer as a consequence of wrongful dishonour. Sometimes, the customer may claim special damages also.

The smaller the cheque dishonoured and greater the damages and vice versa : It is to be noted that the amount of cheque is immaterial for claiming damages. The fact that whether it is wrongfully dishonoured or not is material, which gives rise to cause of action. If the amount is smaller, the greater damages will be awarded. If the amount is greater (high), the damages awarded will be the smaller. The very leading case on this point is –

Davidson vs. Barclay's Bank Ltd (1940) 1 ALL E.R. 316 : In the instant case, the defendant Banker wrongfully dishonoured a cheque for the small amount 2 Pounds 15 Shillings and 8 Pens. The court awarded the damages to the extent f 250 Pounds.

Further, it is to be noted that the liability of the Banker for dishonour extends towards the drawer of the cheque only, not towards the payee. In *Canara Bank vs. I.V. Raja Gopal (1970, MLJ, MAD. 120).*

The plaintiff, a representative of a reputed group of concerns lost his employment as a consequence of wrongful dishonour of cheque by the Banker. The plaintiff presented a cheque on his personal account towards telephone bills of the group of concerns. Consequently, telephone was disconnected and the employer dismissed the services of the plaintiff. In an action by the plaintiff, the Banker (defendant) was held liable to pay Rs. 14,000/- for wrongful dishonour of the cheque for Rs. 294.40 Ps.

Action for Libel : In addition to the claim for damages, wrongful dishonour also gives rise to an action for libel (defamation). It is open to the customer to frame an action against the banker for libel.

Justification of Dishonour : A banker is bound or justified in dishonouring the cheques of his customer under the following circumstances –

(i) Where the customer countermands the payment.,

(ii) Where there are no sufficient funds in the customer's account to meet the cheque.,

(iii) When the funds in the customer's account are meant for being utilized for some other purpose (for instance, the banker has lien over such funds under Sec. 171 of the Negotiable Instruments Act.)

(iv) If the cheque is not properly presented.

(v) when the banker receives the notice of customer's death, bank's authority to pay gets terminated since the funds of the account vests in the legal representatives of the deceased customer.

(vi) When the banker receives the notice of customer's insanity.,

(vii) When the banker receives order from Court, prohibiting the payment.,

(viii) When the cheque is stale or post-dated and

(ix) When the cheque is of doubtful legality.

2. Vicarious Liability of a Banker for the Fraud committed by his Servants

The word 'Vicar' means the person, who performs the functions of another, a substitute. Vicarious liability means "Liability, which is incurred for or instead of another". For instance, liability of a master for the wrong/tort committed by his servant.

Section 238, Indian Contract Act, provides that misrepresentations made, or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreement made by such agents as if such misrepresentations or frauds had been made or committed by the principals; but misrepresentations made, or frauds committed by agents in matters which do not fall within their authority, do not affect their principals. It means that when an agent makes a misrepresentation or commits a fraud, acting in the course of the principal's business, the principal will be vicariously liable for the same. This provision relates to the liability of every principal, including a banker. The position may be explained by referring to the case of –

Lloyd vs. Grace Smith & co. (1912) A.C. 716 : In this case it was held that the master is also held liable for fraudulent acts done by servant for his (Servant's) own benefit.

The defendants were a firm of solicitors. The plaintiff, a widow requested the defendant to prepare documents for sale of her property. But the defendant's servant prepared the documents to transfer the property in his own name. In an action by the plaintiff, the defendant was held liable for the fraudulent act of their servant.

The above view was followed in –

National Bank of Lahore Vs. Sohan Lal, A.I.R. 1962 Punjab 534 : In this case, the appellant (defendant) bank was heid liable for the fraud committed by the Manager of one of its branches.

3. Garnishee Order

When a creditor who has lent money fails to recover the money, he may file a suit against the debtor and obtain a decree from the court for payment of the debt. Sometimes, the creditor may not find any property in the possession or debtor for execution of decree. Yet, there may be some person who is in possession of debtor's property. In such cases the creditor may request the court to issue an

order attaching the debtor's property in the hands of the third party. If the court issues such order, such order is called 'Garnishee Order'.

The word 'Garnishee' is derived from a Latin word 'garnir' which means to warn the third party. Since it is a warning to the third party with regard to property of others in his hand, it is named as garnishee order. As stated above, there are certain cases in which a creditor may request the court to issue an order to attach the property belonging to the judgement debtor in the hands/possession of some third party so as to enable him(creditor) to execute the decree. In such a case, if the court issues order, it is called the 'Garnishee Order'. Section 60 of the Code of Civil Procedure, 1908, lays down the provisions relating Garnishee Order.

The banker has an obligation to honour his customer's cheques, and is liable for wrongful dishonour. Similarly, the Banker has an obligation to stop payment by dishonouring his customer's cheque, when he receives Garnishee Order against his customer's account.

According to section 60 of the Code of Civil Procedure, 1908, debts due to a judgement debtor by third parties are liable to attachment in execution of the decree of Civil Courts. Garnishee Order is an order of the court, issued under Order XXI, Rule 46 of the Code of Civil Procedure, 1908, directing the banker to stop payment to a particular customer, whose name is mentioned in the order.

When a debtor fails to repay his creditor, the latter (creditor) may apply to the court for the issue of a Garnishee Order on the banker of his debtor. By Garnishee Order, the debtor's account with the banker stands suspended and the debtor (customer) will not be allowed to draw, though he has a credit balance. The creditor at whose request, the order is issued is called 'the judgement Creditor', the customer is called judgement debtor; and the banker (debtor of the judgement debtor) is called 'Garnishee'.

Features of Garnishee Order :

(i) It (Garnishee Order) attaches the entire or specific amount of the customer (Judgement Debtor).

(ii) It does not extend to over draft account of the Judgement debtor, though he had not drawn the amount permitted under O.D.

(iii) It is not applicable in case of cheques, bills of exchange, drafts etc. presented by customer and sent for collection (which remain uncleared at the time of order).

(iv) It cannot attach the amounts deposited into the customer's account after the order.

(v) It is not effective in respect of payments already made before the receipt of the order.

(vi) It is not applicable to money held abroad by the Judgement Debtor.

(vii) It is not applicable to securities held in safe custody of the Banker or trustee.

(viii) It may be served on the Head Office of the Bank concerned and it will be treated as sufficient notice to all the branches.

(ix) It is not effective against a joint account in which only one is a judgement debtor or all are not judgement debtors.

(x) It may be issued against income tax defaulters also.

Kinds of Garnishee Order : The Garnishee Order issued by the court is of two kinds namely –

(i) Order Nisi or Preliminary Order and

(ii) Order Absolute or Final Order

(i) Order Nisi : Order Nisi is a preliminary order issued to the banker;

(a) to stop the payment over the customers account.

(b) to give explanation, why the judgement debtors credit balance in his account should not be used for the purpose of payment of the judgement creditor and

(c) it is also a duty of the banker to inform the same to his customer.

(ii) Order Absolute : It is a final order issued by the court to the banker to pay the amount in the judgement debtors account to the judgement creditor (decree holder) according to the direction given by the court.

Effect of Garnishee Order : After receiving garnishee order, banker is justified in dishonouring the cheques of his customer. So customer cannot claim the damages for dishonour.

4. Secrecy of Customer's Accounts

The Banker is under an obligation to take utmost care to maintain the secrecy of his customer's account. Secrecy in the sense, the banker should not

disclose the position of his customers' accounts to any member of the public or Government official except under statutory or lawful authority (Eg. Garnishee Order).

Section 13 of the 'Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, imposes on Banker, such obligation to maintain secrecy of his customer's account. The duty to maintain the secrecy of the customer's account starts the moment the relationship between the banker and customer is established. This duty is not only limited to the bank accounts, but also it extends to all other facts, which may come to the notice/knowledge of the banker from any other sources. The duty/obligation to maintain secrecy of the customer's account was legally imposed on banker in 1924 in a leading case –

Tournier vs. National Provincial and Union Bank of England (1924) 1 K.B. 461) : In this case it was held that the banker must not disclose the position of the customer's account except on reasonable and proper occasions and he should not disclose the state of customer's account even after the account is closed.

Tournier was the plaintiff and National Provincial and Union Bank of England Ltd was the defendant. The plaintiff was working in M/s. Kenyon & Co. on temporary basis and his employment was to be permanent. He overdrew from the defendant bank to a sum of 9 pounds 8 cents 6 d., and he agreed to pay by weekly instalments of 1 pound. Out of this amount, he paid some amount to a bookmaker towards the purchase of certain goods.

On one day, Tournier did not come to duty. The Directors of the Kenyon & Co. telephoned the Bank Manager of the defendant company to know the plaintiff's address. In the conversation, the Bank Manager passed the information that the plaintiff was overdrafted and he made the payment to a bookmaker. The Directors misled the information that the plaintiff was a gambler and was in practice of betting, and also he was insolvent. Therefore, they did not permanent the plaintiff and ousted him from the employment. This caused grievance to the plaintiff, who filed a suit against the bank for not keeping the secrecy of the customer, and for the compensation of the job he lost.

The lower court dismissed his petition. He preferred appeal. The Court of Appeal allowed his appeal and gave the judgement in his favour opining that the Bank Manager violated his duty and caused loss to the customer (plaintiff).

Exceptions : Disclosure of customer's account is justified under the following circumstances :

(i) The Banker's Book of Evidence Act

(ii) The Income Tax Act, 1961

(iii) The Companies Act, 1956

(iv) The Reserve Bank of India Act, 1934

(v) The Banking Regulation Act, 1949

(vi) The Gift Tax Act, 1958

(vii) The Code of Criminal Procedure, 1973 and

(viii) The Foreign Exchange Regulations Act, 1933

(i) The Banker's Book of Evidence Act, 1891 : Under Section 4 of this Act, a banker may be asked to produce the certified copies of entries in the banker's books. *They can be treated as sufficient evidence. Under this Act, a court can order a bank to produce its books of accounts or certified copies.*

(ii) The Income Tax Act, 1961 : Under this Act, the income tax officials can have free access to the books of accounts kept by bank, and to have certified copies if necessary.

(iii) The Companies Act, 1956 : Under Sections 135 to 137, the Central Government has the authority to appoint an officer for enquiry of any Joint Stock Company, and such officer has authorities to inspect the books of a bank to verify the accounts of such company.

(iv) The Reserve Bank of India Act, 1934 : The Reserve Bank is entitled to collect the information from all the banks in India under Section 45(B) of the Act.

(v) The Banking Regulation Act, 1949 : Under section 26 of this Act, every bank has to submit an annual return of deposits unclaimed for 10 years.

(vi) The Gift Tax Act, 1958 : Section 36 of this Act empowers the Gift Tax Authorities with the similar powers of the Income Tax officers under the Income Tax Act.

(vii) The Code of Criminal Procedure, 1973 : Under Section 3 of this Act, the police officer is entitled to inspect the bank account books in due course of investigation in a criminal case. This is also further strengthened by Section 5 of the Bankers Book of Evidence Act, 1891.

(viii) The Foreign Exchange Regulations Act, 1933 : Section 43 of this Act empowers the officers of Directorate of Enforcement and the Reserve Bank of India to inspect the books of accounts of a banker pertaining to a customer etc.

Besides the legal provisions mentioned above, the banker is also obliged to disclose the accounts of his customer, in case a court orders or appoints a Commissioner, a Receiver, an Administrator, an Executor, a Garnishee etc.

Consequences of wrongful disclosure : When the banker improperly discloses any information of his customer's account in which customer incurs any loss, the banker is liable for that. Now banker's liability is of two types i.e.

(a) Liability to the customer, and

(b) Liability to third party.

The customer may sue for breach of contract in case he incurs loss. Sometimes a third party may also incur some loss due to disclosure of the customer's account, then the banker is also liable to the third party;

(a) when he gives such an information with the knowledge that it is false, and

(b) such party acts on that information and suffers a loss.

5. Banker's Obligation for Articles Deposited with the Bank and Valuables kept in Safe Deposit Vaults.

When a cheque, bill of exchange, dividend warrant or other such instrument is deposited with a bank for collection, the bank has a duty to collect the same and credit the customer's account with the proceeds realized. For such collection he serves as an agent of the customer. If a cheque is dishonoured, the bank to whom the same was given for a collection, has a duty to inform the customer of the same, and to return the dishonoured cheque. If a cheque could not be collected and is lost in transit, the bank should inform his customer about the same within a reasonable time (*Syndicate Bank v. Swaika Chemical Works, (1987) 61 Comp. Cas. 752*).

When a customer deposits some cash or other valuables with a bank and the bank employee misappropriates or embezzles the same, acting in the course of the bank's (master's) business, the bank will be liable for the same towards the customer (*Bank of Bihar v. Mahabir Lal, AIR, 1964 SC 377*). However, if some cash or cheques are delivered to a bank employee not at the counter of the bank, but by the customer at her own residence, without obtaining any receipt therefor, the bank's employee in such a case acts outside the course of performance of duties as an agent, and therefore, in such a case the bank would not be liable if such an employee misappropriates the cash or the proceeds of the cheques (*State Bank of India vs. Shyama Devi, AIR, 1978, SC. 1263*).

When some goods are bailed to a bank or certain valuables are pledged with a bank, the bank's duty is that of a bailee or pledgee in respect of such items. The bank has to take due care of the goods bailed (Sec. 151 Indian Contract Act, 1872), and is also bound to return the goods after the purpose has been achieved. The bank will not be liable for the loss, when there is no lack of care on its part. In *Gopal Singh v. Hira Singh (AIR, 1976,Delhi 158)*, the plaintiff firm pledged certain goods with the Jahania office of the defendant bank in 1946. After the partition of the country in August 1947 that area where the branch of the bank was situated became part of Pakistan. The plaintiff firm brought an action for the recovery of more than 2 lakh rupees, being the value of the goods pledged and interest thereon, because the bank failed to return the goods pledged, to the plaintiff firm, who had migrated to India. To avoid the liability, the defendant bank pleaded that the goods pledged had been plundered or destroyed by the rioters in the course of riots which happened to be there at that time. The court found that as the conditions prevailed at that time on the partition of the country, there was insecurity of the life and property of the non-muslim population under the compulsion of adverse circumstances, there was extraordinary breakdown of law and order machinery, and compulsive migration of mass of these persons from Pakistan to India. That was also true about institutions manned by Hindu staff, as was the defendant bank. It was held that under these circumstances, since the property with the bank had to be left uncared there, the bank could not be considered to be guilty of any negligence. It was observed that "the obligation of the bank to take care of the pledged goods must be seen in the context of the extraordinary situation that developed.

Valuables Kept in Safe Deposit Vaults :

A bank is not a bailee of the valuables kept by a customer in a locker of the safe deposit vault of a bank, and therefore, it does not attract the liability of the bank as a bailee in respect of such goods. The position would, however, be different when the lock of a locker has been tampered with by a bank employee before hiring the locker to a customer. In National Bank of Lahore v. Sohan lal (AIR 1962 Punjab 534), the manager of a bank in which the customer had hired a locker and kept his valuables, had filed the levers of the lock before handing over the possession of the locker to the customer. The manager, who was living in the bank premises, could open the locker without the customer's key. He opened the locker and took out the valuables of the customer. The bank was held liable for this fraud of the bank manager. The bank's liability arose in its capacity as bailee, because due to the defective lock, the possession of the valuables kept in

the locker was with the bank, rather than the customer. The bank was also liable on the basis of the principle of vicarious liability, for the fraud committed by its servant(agent) in the course of employment.

When there is no proof of entrusting exclusive control to the bank of jewellery kept in the locker, and also no proof of the contents of the locker, it is not a case of bailment to attract bank's liability for negligence. More so, where there is no sufficient material to hold that robbery occurred due to the bank's negligence, the bank cannot be held liable for alleged loss of jewellery allegedly kept in the bank locker.

In *Atul Mehra v. Bank of Maharashtra (2002 (2) ISJ (Banking) 575 (P&H)*, the customer alleged that he had hired a bank locker and kept jewellery worth Rs. 4,26,100/- and the same was stolen due to the bank's negligence and he claimed compensation in respect of the same.

It was held that –

(i) It was not a case of bailment as there was no exclusive handing over the possession of jewellery to the bank, and in the absence of bailment under section 148 of the Contract Act, bank's liability could not arise.

(ii) The plea that bank robbery had occurred due to the bank's negligence, was also rejected, as there was no sufficient material to hold bank's negligence in the matter. The bank could not be held liable for that reason also.

6. Duty not to close Customer's Account without his consent

Another obligation of the banker is not to close the customer's account without his consent. By closing the account, it severed the relationship between the banker and the customer. Every customer had a right to open an account in any scheduled bank when he satisfies the requirements to open an account. Once money is deposited and it is accepted by the banker, it is his obligation to keep the account without closing even if it is not operated by the customer. When banker wants to close the customer's account, he should inform the customer in writing and it should be accepted by the customer, then only banker can close the account, otherwise the banker is responsible to his customer. If customer wants to close the account, he can do so by sending a written notice to the banker.

LECTURE – III
SPECIAL TYPES OF BANKER'S CUSTOMERS

In discharge of primary function, a banker invites the public to open an account with the bank. Opening of an account with a bank, is creation of a special contract so that the principles of contract viz. capacity to contract, free consent etc. are strictly adhered to. Therefore a banker must be very careful, while opening an account in the name of a customer particularly at the time of opening/accepting accounts in the name of special category of customers viz. minors, partnership firm, joint stock company, club etc. This lecture deals with the precautions to be taken by the Banker, while opening an account in the name of the 'Special Types of Customers' as follows :

1. *Minor*
2. *Illiterate*
3. *Lunatic*
4. *Married woman*
5. *Joint account*
6. *Joint Hindu Family*
7. *Trust account*
8. *Clubs, Societies and Charitable Institutions*
9. *Partnership Firm and*
10. *Joint Stock Companies.*

1. Minor

A minor is a person, who has not completed 18 years of age. The minority extends to 21 years, if a guardian of his person or property is appointed by the Court (Sec. 3 of Indian Majority Act, 1875). Before 1969, in England, the age of minority was 21 years. The age of minority is reduced to 18 years after passing of the Family Law Reforms Act, 1969. In other words, in England also, a person who has not completed the age of 18 years is a minor.

According to Sec. 11 of the Indian Contract Act, 1872, a minor is not competent to contract. A contract entered into by a minor is void ab initio i.e. invalid from the very beginning (as laid down by the Privy Council in *Mohri Bibi vs. Dharmadas Ghose (1903) 30 I.A. 114 (P.C.)*. However, a contract with a minor

for supplying of necessaries to minor or his dependants is valid and enforceable(Sec. 68, Indian Contract Act, under the Principle of Equity)

According to Sec. 26 of the Negotiable Instruments Act, a minor may draw, endorse, deliver and negotiate such instruments so as to bind all the parties, except himself. He need not incur any liability under the negotiable instrument, but he can acquire rights over the instruments. However, the minor is bound by the withdrawals made by him and the bank can legally debit his account.

Therefore, a Banker may open an account in the name of a minor in the following ways –

(a) In the name of the minor or

(b) In the joint names of the minor and his guardian or

(c) In the name of the guardian.

In the first case an account can be operated by the minor himself and there is nothing unlawful, since, Sec. 26 of the Act allows the minor to do so. In the second case, an account can be operated jointly by the minor and his guardian. In the third case, when the account is operated on behalf of the minor, the Minor should have completed 14 years and he must be capable of reading and writing.

As the minor is immune from liability under the contract, the Banker must be very careful and should take the following precautions while dealing with the Minor.

(i) He (the banker) may open savings bank account (and not a current account) in the name of a minor.

(ii) The bank records the date of birth of the minor as given by the minor or his/her guardian. When the minor attains majority, the banker has to close the account and should open a new account in his name as major (i.e. in the name of the minor, who became the major). The credit balance if any (from the account closed) should be transferred/ credited to the new account.

(iii) In case the minor dies, the guardian can be permitted to withdraw the amount. In case of joint account in the names of minor and his/her guardian, the balance will be held at the absolute disposal of the guardian.

(iv) There is no risk involved so long as the minor's account shows credit balance. In case, the minor's account is overdrawn even by mistake or unintentionally, the banker cannot recover the amount. Even if the minor has pledged some asset as security, such pledge itself is invalid and the Banker cannot exercise any lien over it. The reason is, a minor can be a promisee or beneficiary but cannot be a promisor.

(v) The Banker should not grant an advance to a minor even against the guarantee by a third person, who is a major since the contract with minor itself is void, the guarantor or surety also is not liable unless there is some specific provision to that effect.

(vi) A minor may draw, endorse or negotiate a cheque or a bill but he cannot be held liable on such cheque or bill. He cannot be sued in respect of a bill accepted by him during his minority. Such bill or cheque, nevertheless, will be a valid instrument and all other parties will be liable in their respective capacities (Section 26 of the Negotiable Instruments Act, 1881). The banker should, therefore, be very cautious in dealing with a negotiable instrument, to which a minor is a party.

Provisions relating to Guardianship : The guardian of a minor may be either –

(i) A Natural Guardian or

(ii) A Testamentary Guardian or

(iii) A Guardian appointed by the Court.

The first two types of guardians are governed by the provisions of the Hindu Minority and Guardianship Act, 1956, whereas a guardian appointed by a Court under the Guardians and Wards Act, 1890.

(i) Natural Guardian : According to Section 6 of the Hindu Minority and Guardianship Act, 1956, in case of a minor boy or an unmarried girl, his/her father and after him the mother shall be the natural guardian. In case of a married girl(minor), her husband shall be the natural guardian. The terms father or mother does not include step-father or step-mother. If the father becomes a sanyasi or does not remain Hindu, he shall not be entitled to remain as guardian. If the father is alive and is not removed from guardianship, the mother does not become the natural guardian of her minor child.

(ii) Testamentary Guardian : A Hindu father, who is entitled to act as the natural guardian of his minor legitimate children may, by will, appoint a guardian

for any of them in respect of the minor's person or property. Such guardian acts after the death of the father or the mother.

(iii) Guardian appointed by Court : A guardian may be appointed by the Court under the Guardians and Wards Act, 1890, but the Court shall not be authorized to appoint or declare a guardian of the person of a minor, if his father is alive and is not, in the opinion of the Court, unfit to be guardian of the person of the minor. Similar is the case with the minor girl, whose husband is not, in the opinion of the court, unfit to be guardian of her person. Thus the father (or the husband in case of a married girl) is exclusively entitled to be the guardian. The welfare of the minor shall be a paramount consideration of the court while appointing a guardian.

2. Illiterate

Illiterate persons cannot sign their names and hence the bankers take their thumb impression as a substitute for signature, and also a copy of their recent photograph. The application form and the photograph should be attested by an approved witness. For withdrawing money, he must attend personally and affix his thumb impression in the presence of an official of the bank, for the purpose of identification.

3. Lunatic

According to Sec. 12 of the Indian Contract Act, 1872, a person of unsound mind is not competent to enter into a valid contract. A person is said to be of sound mind for the purpose of making a contract if he is capable of understanding it and of forming a rational judgement as to its effect upon his interests (Section 12). It is important that he should be of sound mind at the time he enters into a contract. If a person is usually of unsound mind but occasionally of sound mind, he may make a contract when he is of sound mind. Similarly, if a person is usually of sound mind but occasionally of unsound mind, he cannot enter into a valid contract when he is of unsound mind. A contract entered into by a person of unsound mind is a void contract according to the Indian Contract Act, 1872.

The banker should therefore, not open an account in the name of a person who is of unsound mind. But if a banker has discounted a bill duly written, accepted or endorsed by a lunatic he can realize the money due on the same from such person except in the circumstances where it is proved that the banker was aware of the lunacy of the person concerned at the time he discounted the bill. The banker should suspend all operations on the account of a customer as soon as

he receives the news of his lunacy till he gets the proof of his sanity or is served with an order of the court.

4. Married Woman

A married woman is competent to enter into a valid contract. The banker may, therefore, open an account in the name of a married woman. A married woman has power to draw, hold and endorse cheques, bills etc., and give valid discharge for payments made to her. The banker, before opening an account in the name of married woman, must make necessary enquiries about her husband name, his occupation and the name of his employer and also about her character and social status. In case of overdraft, the banker must find the nature of her right over that property.

The position of a Hindu Married woman is now considerably developed. Section 14 of Hindu Succession Act, 1956 says that property of Hindu female should be absolute property. Under sec. 20 of the Indian Succession Act 1925, a married Mahammad woman is not disqualified by reason of her marriage.

Liability of Husband : In case of debts/loans taken by a married woman, her husband shall not be liable except in the following circumstances :

(i) if the loan is taken with his consent or authority; and

(ii) if the debt is taken for the supply of necessaries of life to the wife, in case the husband defaults in supplying the same to her.

The husband shall not be liable for the debts taken by his wife in any other circumstances. The creditor may in that case recover his debt out of the personal assets of the married woman. While granting a loan to a married woman, the banker should, therefore, examine her own assets and ensure that the same are sufficient to cover the amount of the loan.

5. Joint Account

When two or more persons open an account jointly, it is called a joint account. Such accounts may be opened by any two persons for the sake of convenience of operation of account and also for withdrawal of money after the death of any one of them. The banker should take the following precautions in opening and dealing with a joint account :

(i) The application for opening a joint account must be signed by all the persons intending to open a joint account.

(ii) The banker should obtain clear instructions in writing, signed by all the joint account-holders, regarding the operation of the account. The joint account may be operated in any of the following ways :

(a) By all the depositors jointly

(b) By either or survivor of them

(c) By former or survivor of them.

(iii) The joint account holder, who is authorized to operate the joint account, himself alone cannot appoint an agent or attorney to operate the account on this behalf. Such attorney or agent may be appointed with the consent of all the joint account holders.

(iv) Any joint account holder (including the one who is not authorized to operate the account) can stop payment of a cheque issued on a joint account. Banker must honour such order even if an agent or attorney has been appointed to operate the account.

(v) The full name of the account must be given in all the documents furnished to the banker, even if the account is to be operated upon by one or a few of the joint account-holders.

(vi) The banker should be given clear instructions regarding the withdrawal of securities in the joint account and the power conferred upon the person operating the account to pledge the securities. In case the shares are in the joint names, all such persons must sign the transfer form.

(vii) A joint account may be operated by either of the joint account-holders. But if a cheque is drawn and signed by one of them, any alterations therein should also be done by the same person and not the other one. The alteration should bear the signature of the drawer.

(viii) The persons opening a joint account are also required to give a mandate, in the application form itself, specifying the person to whom the balance in the account shall be payable. The balance in a joint account may be payable to –

(a) both or all of them or the survivor or survivors of them; or

(b) either or any one or more of them or the survivor or survivors of them.

6. Joint Hindu Family

A Joint Hindu Family consists of male, his wife, unmarried daughters and his male descendants. In joint family, there is a narrower body called 'coparcenary' which consists of sons, grandsons and great grand sons of the holder of the Joint Family property. The coparceners get interest in this joint family property by birth. The head of the joint family is KARTA. He is also known as 'Manager'. The father or senior most male member acts as Karta. He (Karta) is empowered to alienate joint family property with the consent of other coparceners. He can alienate the joint family property for the purpose of legal necessity and for benefit to the estate.

A Joint Hindu Family possesses ancestral properties and carries on ancestral business. The ownership of such property passes on to the members of the family according to the Hindu Law. In case of Joint Hindu Family governed by the Mitakshara School of Hindu Law, every male member of a family acquires an interest in the joint property by birth. After the enforcement of the Hindu Succession Act, 1956, the share of a deceased coparcener, who was member of the joint Hindu family is also divisible amongst his wife, daughters and other female relatives as given in the Act. While dealing with the account of a joint Hindu Family and granting it a loan, the banker is naturally faced with a difficult task of ascertaining the rights of the coparceners in the joint family. The following legal precautions should be taken by the banker in this regard :

(i) The family business and its assets are managed by the Karta and hence, the account should be opened in the name of the Karta or in the name of the family business.

(ii) A declaration should be obtained from the Karta and the members that the business in question is 'ancestral' and no outsiders are included as partners.

(iii) The documents should be signed by the Karta or other authorized member/members for operating the account.

(iv) The self acquired properties of the coparceners should not be taken into account as security for obtaining a loan.

(v) The banker, while granting loan, should get the loan documents executed by the Karta and other adult male members of the joint family or with their consent. If there is a minor coparcener, the banker must get the documents signed by the guardian. On attaining majority, the banker must obtain his signature for assent.

(vi) The Banker cannot grant to the Karta, a loan, which is contracted for the purpose of speculative business or starting a new business. The principles relating to borrowing power of Karta were laid down by the Rajasthan High Court in *Ram Dayal & others Vs. Bhanwarlal & others (1973).*

(vii) In case of loan granted to the Karta for the purpose of Joint Family, the liability of coparceners is limited to the extent of their interest in the Joint Family Property. The Banker can insist upon the coparcener to repay the loan taken by Karta, in case he (coparcener) contracted the loan along with the Karta or ratified it.

7. Trust Account

(Trustees)

Meaning of Trust : A trust "is a relationship which arises whenever a person called the trustee is compelled in equity to hold property, whether real or personal and whether by legal or equitable title for the benefit of some persons (of whom he may be one and who are termed *cestui ques trust*) or for some object permitted by law, in such a way that the real benefit of the property occurs not to the trustee but to the beneficiaries or other objects of the trust."

Ordinarily, a banker is a debtor of his customer in respect of the deposits made by the latter, but in certain circumstances he acts as a trustee also. A trustee holds money or assets and performs certain functions for the benefit of some other person called the beneficiary. For example, if the customer deposits securities or other valuables with the banker for safe custody, the latter acts as a trustee of his customer. The customer continues to be the owner of the valuables deposited with the banker. The legal position of the banker as a trustee, therefore, differs from that of a debtor of his customer. In the former case the money or documents held by him are not treated as his own and are not available for distribution amongst his general creditors in case of liquidation. According to the Indian Trusts Act, 1882, a 'trust' is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner (Section 3). The person who reposes the confidence is called the author of the trust. Trustee is the person in whom the confidence is reposed. The person for whose benefit the trust is formed is called the beneficiary. A trust is usually formed by means of a document called the 'Trust Deed'.

According to the opinion of Sir John Paget, the Banker is quite safe in opening an account for persons professing to be trustees of an estate and he is of no obligation to see the trust deed, or other evidence of their appointment. However, others expressed that if the account is a trust account the banker has to take more care and he must not be a party to a breach of trust. Therefore, a banker must be very careful while opening an account in the name of a trust and should take the following precautions –

(i) He should thoroughly study the trust deed, which contains names of the trustees, their powers and details of trust property and other terms.

(ii) In case of two or more trustees, the banker should ask for clear instructions regarding the person or persons who shall operate the account. In the absence of such instructions, all the trustees must sign the cheques, etc., because the estate is placed under their joint charge.

(iii) If one or more of the trustees dies or retires, the authority vested in the remaining trustees depends upon the provisions of the Trust Deed. When all the trustees are dead, new trustees may be appointed by the Court.

(iv) The insolvency of a trustee does not affect the Trust property and the creditors of the trustee cannot recover their claims from such property.

(v) In case of charitable trust, the banker should also examine the registration certificate issued by the Charity Commissioner appointed by the State Government concerned under the Public Trust Act.

(vi) The banker should take all possible precautions to safeguard the interest of the beneficiaries of a Trust, failing which he shall be liable to compensate the latter for any fraud on the part of the trustee.

(vii) The trustees may borrow money from the banker and pledge or mortgage the Trust Property only if the Trust Deed specifically confers such power on them. The banker should, therefore, grant loans to the trustees after thorough examination of the borrowing powers as given in the Trust Deed. To be on the safer side, the banker should grant an advance for a Trust only when the trustees are respectable persons and give personal guarantee also, apart from creating a charge on the assets of the Trust.

8. Clubs, Societies and Charitable Institutions

Clubs, Schools, Colleges, Societies are non-trading institutions. They are created for charitable purpose. They maintain accounts with banks. A banker has to take the following precautions while dealing with such institutions :

(i) The Banker while opening an account, should ensure that the society /club /school is incorporated. An incorporation (registered) society will have legal personality to sue and be sued.

(ii) He (Banker) has to insist upon the society (club, school, college etc.) to submit a copy of its by-laws so as to enable him to know its constitution and powers of the persons managing it.

(iii) The Banker has to obtain a copy of the 'Resolution of the Managing Committee' so as to know the person/persons authorized to operate the account and other conditions if any.

(iv) In the event of death or resignation of the person/persons authorized to operate the account, the Banker has to stop operation of the account till another person is nominated.

(v) The person authorized to operate the society's account may also have personal account. Then the Banker has to act diligently that the funds are not diverted/transferred from society's account to the personal account.

9. Partnership Firm

When two or more persons(subject to a maximum of 10 in Banking and 2 in non-banking) carry on business to share profits and losses equally or in proportion of capitals, it is called 'Partnership business'. The Indian Partnership Act, 1932 defines partnership as "the relation between the persons who have agreed to share the profits of the business carried on by all, or by any one of them acting for all." The persons are called 'Partners' and the business is called 'Partnership Firm'. In partnership, the liability of partners is unlimited.

Features of Partnership : The following are the essential features of a partnership firm.

(i) The existence of written or implied agreement to do lawful business.

(ii) To share profits.

(iii) Dual role of every partners as principal and agent.

(iv) Partner's implied authority to bind all other partners by his conduct in the ordinary course of the business.

(v) The maximum number of partners is 20 and the minimum number is 2. In the case of banking firms, the maximum number of partners is 10.

A banker should take the following precautions, while opening an account in the name of a partnership firm :

(i) He (Banker) must examine carefully, the partnership deed to acquaint himself with the constitution and business of the firm.

(ii) He must check that the number of partners is not less than two and not more than 10 in case of banking business and 20 in case of non-banking business.

(iii) The account should be opened in the name of the firm, not in the name of partner/partners.

(iv) The Banker can insist all the partners to join, to open the account, and must obtain specimen signatures of all the partners.

(v) The Banker should take a letter or mandate containing :

(a) the names and addresses of the partners;

(b) nature of business undertaken by the firm;

(c) name/names of the partner/partners who will operate the account.

(vi) If a cheque in favour of firm is endorsed to a partner, the banker should not honour it without making necessary enquiry.

(vii) If there is a minor partner, his date of majority should be obtained to ensure that a fresh partnership later signed by him on attaining majority.

10. Joint Stock Companies

A company is an artificial person, created by law with perpetual existence and common seal. To acquire legal personality (to sue and be sued) it must be incorporated/registered under the Indian Companies Act, 1956. A Banker has to take the following precautions while opening an account in the name of a Joint Stock Company.

(i) He(Banker) must ensure that the company (applicant to open an account in the Bank) is incorporated/registered under the Indian Companies Act, 1956 (so that the Banker can sue the company for default or breach of contract if any in future).

(ii) He has to thoroughly examine the following documents of the company –

(a) Certificate of Incorporation, issued by the Registrar of Joint Stock Companies to ensure that the company (whether Private Limited or Public Limited) is incorporated under Companies Act.

(b) Certificate of Commencement of Business in case, the applicant is a Public Limited Company. (A Private Company can start business after getting the certificate of Incorporation. But a public company can start business only after obtaining the certificate of commencement of Business issued by the Registrar of Joint Stock Companies).

(c) Memorandum of Association and Articles of Association are the most important documents, submitted to the Registrar for Incorporation. Memorandum contains the relationship between the company and outsiders(public) while the Articles contain the constitution of the company.

(iii) He must obtain from the applicant, a copy of the 'Resolution passed by the Board of Directors' –

(a) to ensure that the Bank is appointed as 'Banker of the Company'.

(b) to know the persons authorized to operate the Account; and

(c) to know the borrowing power of the company and the persons so authorized to borrow.

(iv) If the person authorized to operate the company's account is having his personal account also with the bank, the banker must properly enquire about the cheques endorsed and deposited in personal account so as to avoid unauthorized transfer/diversion of Company's funds.

LECTURE IV
RESERVE BANK OF INDIA

This lecture covers –

1. Functions of Reserve Bank of India

(i) Banker to the Government

(ii) Note-issuing Authority.

(iii) Banker to the Commercial Banks.

(iv) Credit Controller.

2. Organisation of the Reserve Bank of India

3. Reserve Bank and Commercial Banks

(i) The Bank Rate

(ii) Open Market Operations

(iii) Variable Reserve Requirements

4.The Reserve Bank and its Promotional Role

Today there is a central bank for each and every country in the world. The Reserve Bank of India is the Central Bank of our country. It was established under the Reserve Bank of India Act, 1934 and started functioning from April 1, 1935. It was nationalized with effect from January 1, 1949. It performs variety of functions, both traditional and promotional.

Capital : When the Bank was started, its share capital was Rs. 5 crore divided into shares of Rs. 100 each fully paid up. The entire share capital in the beginning was owned by private shareholders. The Government of India held shares of nominal value of Rs. 2.22 lakh. When it was nationalised in 1949, the Government paid compensation at the rate of Rs. 118.58 for each share (value is Rs. 10).

1. Functions of Reserve Bank

The Reserve Bank of India performs all such functions, which the Central Bank of a country performs as explained hereunder –

(i) Banker to the Government.

(ii) Note-issuing Authority.

(iii) Banker to the Commercial Banks.

(iv) Credit Controller.

(i) Banker to the Government: The Reserve Bank of India is the Central Bank of our country and hence, it acts as banker to the Central and State Governments. Section 20 of the Reserve Bank of India Act, 1934, imposes on the bank obligation/duty to transact all Government business including the management of the public debt of the Union. According to Sec. 21, the Union Government entrust the Reserve Bank, all its money, remittances, exchange and banking transactions and in particular deposit free of interest all its cash balances with the bank. It also acts as an advisor to the Government on important economic and financial matters.

According to Sec. 45 of the Reserve Bank of India Act, 1934 it is obligatory on the part of the Reserve Bank of India to appoint State Bank of India as its sole agent at all places, where Reserve Bank's branch or office or subsidiary bank is not available. As a banker's bank, it performs the following functions –

(i) **A custodian of cash reserves and a bank of clearance :** The RBI acts as the custodian of cash reserves of the commercial banks. In some countries law requires that a certain portion of the deposits of the commercial banks should be kept with the central bank. In India, for example, the commercial banks must keep 3 % of the total demand and time liabilities with the Reserve Bank. The advantages of centralization of cash reserves are as follows :

(a) It is source of great strength to the banking system. The general public feel confident of the solvency of the banks.

(b) These centralized cash reserves can be effectively employed during general emergencies. When a bank is faced with heavy withdrawals, these reserves may be lent to the bank concerned. Even if there is a general emergency, these reserves can be used to increase the amount of funds available.

(c) The cash reserves acquire mobility. In a country like India, financial needs do not arise in all the parts of the country at the same time. In such cases banks in some regions can keep the surplus reserves with the Central Bank. The reserves may be lent to the banks situated in other regions where there is financial emergency.

(d) The cash reserves are conducive to economy and increase elasticity and liquidity of the banking system. In the absence of a central bank and centralized cash reserves, each commercial bank would have to

maintain a higher cash reserve. With a central bank to fall back upon in times of need, the commercial banks can conduct their business with smaller cash reserves. Moreover, these reserves enable the central bank to rediscount bills or lend money to the commercial banks on gilt edged securities.

(e) There is one more advantage of these cash reserves. These reserves can be used by the central bank to settle the inter-bank indebtedness. All the commercial banks maintain accounts with the RBI. The central bank can undertake clearing of cheques, drafts, bills etc. The settlement is made just by passing a book-keeping entry. This function enables the central bank to test the general liquidity of the banking system. In the absence of this central clearance and settlements, each commercial bank would have to maintain a higher cash reserve.

(f) By varying these reserves the central bank can control credit. For example, the Reserve Bank can vary the cash reserve between 3 and 15 percent. This is the most important function of centralized cash reserves.

(ii) **As a bank of rediscount and lender of the last resort :** The RBI acts as a lender of the last resort. The function has developed out of the special position of the bank issue. The RBI will be performing the function of the lender of last resort when it rediscounts the bills of exchange brought by the commercial banks.

Rediscounting has been defined as the conversion of bank credit into central bank credit. Originally, the term rediscount is applied only to trade bills brought by the commercial banks and discount houses which were in need of funds. With the decline of trade bills due to evolution of new methods of financing trade, the bank grants loans to commercial banks.

(iii)The RBI undertakes supervision and regulation of Banks as per the provisions of the Banking Regulation Act, 1949. It is also armed with powers to supervise banks and give directions under the RBI Act 1934. It grants licences for establishment of banks; it undertakes supervision of banks.

(ii) Note-issuing Authority : The Reserve Bank is empowered to regulate the issue of currency in India under section 22 of the Reserve Bank of India Act, 1934. It has two departments namely Issuing Department, and Banking Department. One rupee notes and coins are issued by the Central Government and currency notes are issued by the Reserve Bank. The issuing department releases currency against the assets viz. Gold Coins, Foreign Security, Rupee

Coins and Securities. The RBI has a separate issue department entrusted with the issue of notes. Currency notes are issued under the principle of minimum reserve system since 1957. The RBI is required to maintain gold and foreign exchange reserves of Rs. 200 crore, of which atleast Rs. 115 crore should be in gold. There is no maximum limit on note issue.

(iii) Banker to the Commercial Banks: Acts as a Banker to the commercial banks. Just as the private individuals maintain accounts with the commercial banks, the commercial banks also maintain accounts with the Reserve Bank of India. The commercial banks have statutory obligation to deposit with the Reserve Bank, a part of their deposits (between 3 % and 15 %).

Commercial Banks approach the Reserve Bank for advances under emergency situations. It (RBI) charges High rate of interest (with an intention to make the commercial bank stand on their own legs without resorting financial assistance). Thus, the commercial banks, in times of need try to secure the funds from various sources and approach the Reserve Bank in a last attempt. Hence, it is called as 'the lender of last resort'.

(iv) Credit Controller : Banks are not merely purveyors of money but also manufacturers of money. Bank deposits from a large part of the total supply of money in circulation and by their power to create money has made them economically significant. If banks choose to create more money, inflationary forces may develop involving undesirable economic consequences. By contracting the supply of money they can arrest economic prosperity and bring deflationary forces into existence. Because of their power to create money, banks have come to play a crucial role in the economy.

Bank credit means bank loans and advances. A bank keeps a certain proportion of its deposits as minimum reserve for meeting the demand of the depositors and lends out the remaining excess reserve to earn income. The bank loan is not paid directly to the borrower but is only credited to his account. Every bank loan creates an equivalent deposit in the bank. Thus, credit creation means multiple expansion of bank deposits. The word 'creation' refers to the ability of the bank to expand deposits as a multiple of its reserves.

In nut shell, credit creation refers to the unique power of the banks to multiply loans and advances, and hence deposits. With a little cash in hand, the banks can create additional purchasing power to a considerable degree. It is because of the multiple credit creating power that the commercial banks have been aptly called the 'factories of credit' or 'manufacturers of money'. In the

words of Newlyn, "Credit creation refers to the power of commercial banks to expand secondary deposits either through the process of making loans or through investment in securities." According to Halm, "The creation of derivative deposits is identical with what is commonly called the creation of credit."

Reserve Bank plays significant role in controlling the credit, created by the commercial banks. When a commercial bank grants an advance to a customer, it simply gives credit to his account and thereby creates deposits/credit. Unless there is proper control over such credit creation, it results in inflation and other financial evils/ constraints in the country.

The RBI exercises control over the credit granted by the commercial banks, by changing the statutory requirement regarding maintenance of liquid assets, by issuing directives under Section 21 of the Banking Regulation Act, 1949, by changing statutory reserve maintained by the Scheduled Banks, by changing the Bank Rate and its policy of granting accommodation to the commercial banks, by exercising normal influence on the banks and through its credit monitoring arrangement.

RBI has various weapons of credit control. By using them, it tries to maintain monetary stability. The weapons of credit control are broadly divided into (a) quantitative controls and (b) qualitative/selective credit controls. Quantitative controls regulate the volume of total credit. Qualitative or selective controls regulate the flow of credit for various uses and purposes. The quantitative credit-control instruments are Bank Rate, Open Market Operations and variation of Cash Reserve Ratio(CRR).

It also acts as a 'clearing house' by giving debits and corresponding credits to the respective commercial banks' accounts with the Reserve Bank. For instance, State Bank owes Rs. 15 lacs to Andhra Bank. Similarly, Andhra Bank owes Rs.10 lacs to State Bank. Both State Bank and Andhra Bank have their accounts with the RBI. Then, the RBI gives a credit of Rs. 5 lacs to Andhra Bank against a corresponding debit to the State Bank.

2. Organisation of the Reserve Bank of India

The affairs of the Reserve Bank of India are managed by the Central Board of Directors. The Central Board of Directors consists of :

(i) a Governor and not more than four Deputy-Governors appointed by the Central Government under Section 8(1)(a) of the Reserve Bank of India Act, 1934,

(ii) four Directors nominated by the Central Government, one from each of the four Local Boards in terms of Section 8(1)(b),

(iii) ten Directors nominated by the Central Government under Section 8(1) (c), and

(iv) one Government official nominated by the Central Government under Section 8(1)(d).

The Reserve Bank of India has Local Boards with Headquarters at Bombay(Mumbai), Calcutta(Kolkata), Madras(Chennai) and New Delhi. Local Boards consist of five members and these members are appointed by the Central Government as far as possible to represent territorial and economic interest, the interest of co-operatives and indigenous banks.

The Chairman of the Central Board of Directors of the Reserve Bank of India is called the Chief Executive Authority of the Bank and he is known as the Governor. The Governor has the powers of general Superintendence and direction of the affairs and business of the bank and he is authorized to exercise all powers, which may be exercised or done by the bank. In the absence of the Governor, the Deputy-Governor nominated by him in this behalf exercises his powers.

3. Reserve Bank and Commercial Banks

By virtue of powers conferred under the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 the Reserve Bank is empowered to regulate the commercial banks by exercising certain powers as follows :

(i) It (Reserve Bank) acts as a supervisory authority of commercial banks. It issues licences to banking companies (Sec. 22, Banking Companies Regulation Act).

(ii) Every banking company shall take the permission of the Reserve Bank for opening its new branch anywhere (Sec. 23)

(iii) It has power to inspect (Sec. 35) and issue directions (Sec. 35-A) to commercial banks.

(iv) It has control over the managements of commercial banks. The management of any commercial bank has to obtain prior permission from the Reserve Bank of India for appointment or re-appointment of a Chairman, Managing Director etc.; and

(v) It controls the credit created by the commercial banks and prevents inflation and economic instability.

(vi) Under Sec. 35 (b) of the Banking Regulation Act, 1949, the approval of the Reserve Bank of India is necessary for the appointment or re-appointment or termination of an appointment of a Chairman, Managing or Whole time Director.

(vii) Under Section 21, the Reserve Bank of India has been given a power to control advances granted by the commercial banks. This power is known as the power of Selective Credit Control.

Apart from the Selective Control of Credit exercised by the Reserve Bank of India, the Reserve Bank of India controls the volume of credit in a quantitative way so as to influence the total volume of bank credit. The Reserve Bank of India does this through the use of following instruments:

(i) The Bank Rate

(ii) Open Market Operations

(iii) Variable Cash Reserve Requirements.

(i) The Bank Rate : The Bank Rate is the rate of interest at which the Reserve Bank of India re-discounts the first class bills of exchange from commercial banks or other eligible paper. Whenever the Reserve Bank of India wants to reduce credit, the bank rate is raised and whenever the volume of bank credits is to be expanded, the bank rate is reduced. This is because by change in the bank rate, the Reserve Bank of India seeks to influence the cost of bank credit. In India the bank rate has been changed frequently from 1951 onwards and today the bank rate stands at 10 %. However, the efficacy of the bank rate depends on the extent of integration in the money market and also it depends upon how far the commercial banks resort to borrowings from the Reserve Bank of India.

(ii) Open Market Operations : The Reserve Bank of India can influence the reserves of commercial banks, i.e., the cash base of commercial banks by buying or selling Government Securities in open market. If the Reserve Bank of India buys Government Securities in the market from commercial banks, there is transfer of cash from the Reserve Bank of India to the commercial banks and this increases the cash base of the commercial banks enabling them to expand credit and conversely if the Reserve Bank of India sells Government Securities to the Commercial Banks, the commercial banks transfer cash to the Reserve Bank of India and therefore their cash base is reduced thus adversely affecting the capacity of commercial banks to expand credit. The success of open market operation as a technique of credit control depends upon the size of Government Securities available, their range in variety and the ability of the market to absorb them.

(iii) Variable Reserve Requirements : The commercial banks are required to keep a certain percentage of deposits as reserves with the Reserve Bank of India. The Reserve Bank of India is legally authorized to raise or lower the minimum reserves that the bank must maintain against the total deposits. If the percentage of reserves to be maintained is increased, the commercial banks will be left with less cash and therefore, they have to contract credit and if this limit is reduced, the commercial banks will have more cash with them and they would be able to expand credit. The Reserve Bank of India has got the power to use the variable reserve requirements as an instrument of monetary control only in 1956 when the bank was authorized to vary the minimum cash reserve requirement to be maintained by commercial banks between 5 % and 20 % of demand deposits and 2 % and 8 % of time deposits.

4. The Reserve Bank and its Promotional Role

The Reserve Bank of India, as the Central Bank of our country is playing a predominant role for promoting economic growth as per the guidelines of the Central Government. After 1948, it took variety of steps for promoting financial institutions and established well organised money market in the country. The steps taken by the Reserve Bank are summarized below :

(i) For opening a new bank in the country, a licence is required for the purpose from the R.B.I. and permission to open new branches of a bank also is required from RBI.

(ii) The RBI is empowered to inspect the operations, lending policies, position of assets, quality of supervision, investments etc. of the banks and their branches.

(iii) It helped in establishment of financial corporations to provide credit to the agricultural and industrial sectors.

(iv) It extended banking facility to rural areas by creating rural banks with the help of commercial banks.

(v) It encouraged the commercial banks to open their branches in the foreign countries to promote foreign trade.

(vi) It encourages and promotes research in the areas of banking.

The Reserve Bank of India has played its special role in the development, control and functions of the commercial banks. It acts as supervisory and controlling authority over the banks. The Banking Regulation Act, 1949 confers wide powers upon it to supervise and control the affairs of the banking companies.

Under Section 22, all banks are required to hold a licence from the Reserve Bank of India.

Under Section 23, every banking company is required to take the Reserve Bank's prior permission for opening a new place of business in India or to change the location of an existing place of business in India or outside.

Under Section 35, the Reserve Bank has power to inspect the working of the Banking Companies.

Under Section 35 A, the Reserve Bank has been empowered to issue directions to a banking company or companies in the public interest or in the interest of banking policy or to prevent the affairs of the banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company or to secure proper management of the banking company.

Under Section 36, the Reserve Bank of India has been empowered to caution or prohibit the banking companies against entering into any particular transaction and generally give advice to any banking company.

Under Section 36 A, the Reserve Bank is empowered to remove from office any Chairman, Director, Chief Executive Officer or other officer or employee of a bank, if it considers necessary or desirable to do so.

Under Section 24, every banking company has to maintain in cash, gold or unencumbered approved securities an amount which shall not, at the close of business on any day be less than 25 percent of its net demand and time liabilities in India. Since 1983, this statutory liquidity ratio (SLR) can be raised upto 40 percent by the Reserve Bank of India.

Under Section 21, the Reserve Bank is empowered to issue directives to the banking companies to determine the policy relating to advances to be followed by them.

Under Section 42, the Reserve Bank can raise or lower down the statutory reserve maintained by the Scheduled Banks with the Reserve Bank.

The Reserve Bank of India acts as a credit planner of the banks : The Reserve Bank acts as lender to commercial banks. It grants accommodation to the scheduled banks by –

(i) re-discounting or purchase of eligible bills; and

(ii) loans and advances against certain securities.

Under Section 17(2) the following categories of bills are eligible for re-discounting with the Reserve Bank of India :

(i) Commercial Bills;

(ii) Bills for financing agricultural operations;

(iii) Bills for financing cottage and small scale industries;

(iv) Bills for holding or trading in Government Securities;

(v) Foreign Bills.

The bills eligible for re-discounting are required to have a fixed maturity.

The Commercial Banks and Co-operative Banks are also allowed to be granted emergency advances by the Reserve Bank on special occasions, if the Reserve Bank is satisfied that the grant of such loans is necessary for the purpose of regulating credit in the interests of Indian Trade, commerce, industry and agriculture.

LECTURE V
PASS BOOK

(Statement of Account)

This lecture covers –

1. *Meaning*
2. *Specimen/Format of Pass Book*
3. *Effect of Entries in the Pass Book*
   - *(i) Entries favourable to customer;*
   - *(ii) Bank entitled to recover in case of over-crediting customer's account;*
   - *(iii) Customer entitled in case bank over-debit a customer's account ;*
   - *(iv) Entries favourable to Banker and*
   - *(v) Effect of false entry in the pass book.*

1. Meaning : The banks supply his customer either with a pass-book or with statements of account at regular intervals. The banker is expected to high standard of accuracy in their book-keeping and in writing up of pass-books or preparation of statements. Pass-book is a booklet issued by the banker to his customer, wherein all the transactions between the banker and the customer are recorded. It is the replica of the customer's account in the banker's books. In other words, Pass-Book is a book, which passes between the Banker and customer periodically (from time to time), containing the record of customer's account. It appears in banker's books, containing a copy of the customer's ledger account. The reason why it is called pass book is, it passes between banker and customer and from the customer to the banker. It is also known as 'Statement of Account'.

Sir John Paget, in his 'Law of Banking' (4th Edn. P-294) says "Its proper function is to constitute a conclusive and unquestionable record of the transactions between banker and customer and it should be recognized as such".

The main purpose of the passbook is to enable the customer –

(i) to acquaint himself with the banker,

(ii) to know/check whether entries as to day to day transactions are properly entered/recorded in the passbook,

(iii) to prepare bank reconciliation statement,

(iv) to treat the account got settled.

2. Specimen/Format of the Bank Pass Book

Date	Particulars	Dr. Rs.	Cr. Rs.	Balance Rs. Ps.	Acct's initials

Features : The important features of the pass book are :

(i) Entries in the pass book are to be made by the bank staff only. The customer cannot make any entry in the pass book.

(ii) It must be sent by the customer periodically to the banker to up-to-date entries.

(iii) In case of a Savings Account, the pass book must accompany the withdrawal slip, unless there is cheque book facility.

Now a days some banks particularly the new private sector banks and foreign banks send statements of account periodically (monthly) in lieu of pass book.

Is Pass Book a Conclusive Proof of evidence of entries made therein.

According to Sir John Paget, a learned writer, the proper function of a pass book is to constitute a conclusive and unquestionable record of the transactions between the banker and the customer and it should be recognized as such (Devaynes vs. Noble). He also added that on delivery of the Pass Book to the customer, he examines it and if there appears any error or omission brings it back to be rectified, or if not, his silence is regarded as an admission that the entries are correct. This view appears to be reasonable and ideal. But the legal position in England and India is different, as can be seen from several legal decisions.

Duty of Customer to Examine Pass Book : There is a conflict of opinion as to the question, whether the customer has a duty/obligation to examine the pass book ? In U.S.A., this question was answered in affirmative i.e. the customer has a duty to examine his pass book. This view was laid down in *Bank of England v. Vaglian (1891) A.C. 107.* Similar view was also laid down in *Morgan v. U.S. Mortgage and Trust Co. (1913) 208 New York Rep. 218).* However, the question was answered in negative in -

Kepitigalle Rubber Estate v. National Bank of India (1909) 2 K.B. 1010) : In this case, Justice Bray held that, there was no duty on the part of the customer to examine his pass book.

Similarly, in India, the Supreme Court in Canara Bank v. Canara Sales Corporation (AIR 1987, SC 380) held that even if there was some negligence or inaction on the part of the customer in not being careful in detecting the error in the pass-book, the customer is entitled to recover the amount paid under a forged change.

The customer is at liberty to bring to the notice of the banker, the mistakes or omissions, if any in the pass book and can get them corrected. Thus, the entries in the pass book do not form the conclusive evidence of their correctness or accuracy.

3. Effect of Entries in the pass-book : The effect of entries made by mistake may be explained with reference to the following heads –

(i) Entries favourable to customer;

(ii) Bank entitled to recover in case of over-crediting customer's account;

(iii) Customer entitled in case bank over-debit a customer's account ;

(iv) Entries favourable to Banker and

(v) Effect of false entry in the pass book.

(i) Entries Favourable to Customer : The customer is expected to act according to the contents of his pass book. Some times, the banker by mistake, may give wrong credit to the customer's account. If the customer, relying on the credit balance as shown in the pass book, draws a cheque, in good faith, the banker must honour the same. Otherwise, the banker is liable for wrongful dishonour (Halland vs. Manchester and Liverpool District Banking Company Ltd.)

The Madras High Court in – *Oakley Bowden & Co. Vs. Indian Bank Ltd. (AIR 1964, Mad. 202)* enunciated that " Generally speaking, a bank owes a duty to its customer to maintain proper and accurate accounts of credits and debits. If a bank makes a wrong credit intimating the same to the customer, the bank thereafter will be estopped from contending that the credit entries were wrongly made and the amount credited should be refunded by the customer.

The above principle of Estoppel is not applicable if the bank sends pass book regularly to the customer and the customer maintains his account regularly.

If the banker discovers any wrong credit, he must communicate the same to the customer and should not honour the cheque (drawn by the customer relying on the entries in the pass book) until the matter has been cleared up. Similarly, a customer should not rely upon a fictitious entry made by a banker, not communicated to him.

(ii) Bank entitled to recover in case of over-crediting customer's account :If the bank over-credits a customer's account by mistake, the bank may recover the amount over-credited in the statement of account or pass-book. In *British & North European Bank v. Zalstein, (1927) 2 K.B. 92),* a customer was overdrawn 900 pounds in excess of the agreed limit and in order to conceal this fact from the bank auditors, the branch manager transferred 2000 pounds from another source to the credit of the customer's account. Later on the manager debited the customer's account with the same sum. The customer was not aware of the entries. Later on the bank sued the customer for overdraft. The customer pleaded the benefit of credit entry. But the court held that he was not entitled to do so. Similarly, in *United Overseas Bank vs. Jiwani (1976) WLR 964)*, where the bank credited the current account of the customer on the basis of telex message and again on the advice of T.T. and the customer withdrawn the said amount, it was held that the amount credited to the account erroneously can be recovered by the bank.

(iii) Customer entitled in case bank over-debit a customer's account : Where the bank pays the forged cheque and debit the said payment in the customer's account and the customer does not point out the mistake immediately to the Bank, the Bank is liable to pay the amount. Where cheques were forged and drawn on company's account over a period of two months, and pass book had been written up several times during that period and the directors had not examined it, it was held that the bank cannot charge the company with the amounts paid out on forged cheques. Similarly in *Tai Hing Cotton Mills Ltd v. Liu Chong Hing Bank Ltd & others, (1985) 2 All Ex. 947)*, the Judicial Committee held that the banks which had paid out on forged cheques were not entitled to debit their customer's accounts, unless it was otherwise agreed.

In *Canara Bank v. Canara Sales Corpn. (AIR 1987 SC 1603*), the Supreme Court held that the bank cannot debit the amount of forged cheques to the customer's account. The bank cannot expect the customer to look into the pass-book or the statement of account so minutely. The statement sent by the bank are either not readable, decipherable or legible. The relation between the banker and customer is based on trust and when forged cheques are presented for payment, there is no mandate on the bank by the customer to pay such cheques. There is no

duty for the customer to inform the bank about the fraud committed of which he has no knowledge. The customer can be held liable only when the customer had the knowledge about the fraud. Mere inaction on the part of the customer cannot absolve the bank from its liability to the customer and that by itself cannot cast a liability on the customer. The Court did not accept the bank's contention that when the customer had confirmed the balance in his account and also does not raise objection as to the statement of account then the entries should be deemed to be final and such entries cannot be re-opened for reconstruction.

(iv) Entries Favourable to Banker : When the banker has omitted to give credit or has wrongfully given a debit to his customer's account, it is advantageous or favourable to him (Banker). With regard to such entries favourable to the banker, the position as to what extent the customer is bound, is uncertain. However, the banker must accept the fact that the customer is under no duty to examine his statement or acknowledge that the entries are correct *(Kepitigalle Rubber Estate v. National Bank of India (1909) 2 K.B. 1010).*

The customer is entitled to get the mistake rectified, when ever he detects such mistake, and can recover the amount wrongly debited to or omitted to be credited to his account. However, this right of customer is subject to a limitation. If the customer comes to know about the forgery in the cheque and does not inform the bank, it amounts to negligence on the part of the customer.

(v) Effect of False Entry in the Pass Book : The question is, whether the banker is liable for the loss caused to the customer as a consequence of false entries posted in the pass book by the bank employee. The Supreme Court considered this question in – *State Bank of India vs. Shyama Devi,* AIR 1978, SC 1263.

Facts : The plaintiff, a lady opened a saving bank account in the defendant Bank. She entrusted from time to time, her money and cheques to her neighbour, who is an employee of the defendant bank, to be credited to her account. He misappropriated the amounts and posted false entries (credits) in her pass book. She sued the bank for false entries in her pass book.

It was argued from plaintiff side that the entries in the pass book were prima facie sufficient to establish the customer's claim. The bank(defendant) argued that the customer(plaintiff) had entrusted the money to bank employee as her agent. In such situation, the bank employee could not be said to have been acting in due course of bank's employment or as an agent of the bank. He was only an agent of the customer. The Supreme Court admitted the contention of the defendant bank and held that the defendant bank was not liable.

Confirmation of balance confirmation by customer : The banks send letters to the customers periodically intimating them the balance standing to their account and requesting the customer to confirm the balance. The court held that if the customer confirms the balance, then the customer is bound by such entries in the account and he is estopped from disputing the entries subsequently *(Essa Ismal v. Indian Bank,(AIR 1963 Ker 104)*. But in case the forged cheque has been debited and even the customer confirms the balance, the customer can still recover the amount debited to his account on the basis of forged cheques. In such situation, the plea of estoppel or adoption cannot stand in absence of evidence that the customer himself was negligent, which was the proximate cause of the loss.

LECTURE VI
LETTERS OF CREDIT

This lecture covers –

1.Meaning

2.Kinds of Letters of Credit

(i) Travellers' letters of credit;

(ii) Letters of commercial credit.

3.Types of Commercial Letters of Credit

(i) Documentary letter of credit and clean letter of credit;

(ii) Fixed credit and Revolving Credit ;

(iii) Revocable and Irrevocable letters of credit;

(iv) Confirmed and unconfirmed letters of credit ;

(v) 'With' and 'without' Recourse Letters of Credit ;

(vi) Transferable and non-transferable letters of credit ;

(vii) Back to back letter of credit ; and

(viii) Red-Clause letter of credit.

(ix) Clean letter of credit

(x) Revolving Letter of credit

4. Advantages of Letters of Credit

(A) Advantages to the Importer

(B) Advantages to the Exporter

1. Meaning : Modern commercial banks, in addition to borrowing and lending (primary services) render a variety of agency/subsidiary services. The prominent and most important among them is, issue of the letter of credit (bank guarantee) to its customer. A letter of credit is an open letter or a request whereby one person, the banker, request the other person to pay the amount named therein or accept the bill of exchange drawn upon him for the like amount.

In a contract of guarantee, a creditor can confidently lend money to the debtor at the instance of surety. Similarly, a bank acts as a surety by issuing a letter of credit to its customer. In simple, letter of credit is a letter of surety or guarantee assuring payment of a debt at the default of its customer. It is an

instrument issued by a banker in favour of traders and banks to provide financial assistance to the customer. By issuing the letter of credit, a banker requests the other party (a banker or a trader) to grant a specified amount to a person, whose name is specified therein. The issuing banker himself binds to pay under the letter of credit. In simple, bank by issuing letters of credit, acts as an agent between the parties to indemnify the loss at the default of the purchaser/importer. For instance, in international trade (foreign trade), the buyer and seller are unfamiliar with each other. In such cases, banks, by issuing letters of credit ensure security of payment/supply of goods to the parties (buyer and seller). In this way, a banker by issuing the letter of credit acts as a mediator / bridge between the citizen of one country and the citizen of another country.

2. Kinds of Letters of Credit : Letters of credit are of two types as follows –

(i) Travellers' letters of credit; and

(ii) Letters of commercial credit.

(i) Travellers' letter of credit

It is a letter of credit issued by one bank to another branch of the same bank for the purpose of facilitating the traveling of the customer. If it is issued on more than one branch then it is called circular letter of credit. It helps traders/travelers, who travel within the country or abroad, from the risk of carrying cash. Banks by issuing Travellers' letters of credit, protect the travelers from the risk of theft etc.

Characterstic Features : Following are the characterstics of the travellers' letter of credit :

(i) It (travellers' letter of credit) is issued by a bank on its own branch/ branches or corresponding bank in the country or abroad. (It is called circular letter of credit, if it is addressed to more than one bank).

(ii) It contains request by the issuing bank to the paying bank to pay up to a specified sum of money to the holder, whose name is specified therein.

(iii) Its back (reverse) side contains a proforma to furnish the particulars of payment made by the paying bank/banks.

(iv) It is also enclosed by a letter of identification, containing the specimen signature of the payee.

(v) The holder/payee shall issue drafts drawn on issuing banker, to the paying banker for re-imbursement (of the amount paid).

(vi) The applicant has to deposit the amount(which he could draw against the letter of credit) with the issuing bank. Or he may also give a letter of guarantee to that effect. It is called 'Guarantee Letter of Credit'.

(ii) Letters of Commercial Credit

When any letter of credit is issued for the purpose of business, then it is called commercial letter of credit. It is a letter issued by the banker of foreign buyer at the request of the buyer in favour of the exporter informing that the issuing banker accept the bills drawn in respect of the exports made to the foreign buyer. Letters of commercial credit play an important role in growth and development of trade and commerce in general and foreign trade in particular. An exporter may not be able to dispatch the goods unless the importer arranges letter of credit.

"A Commercial Letter of Credit is a letter issued by the banker of the foreign buyer, at the latter's request, in favour of the exporter informing him that the issuing banker undertakes to accept the bills drawn in respect of exports made to the foreign buyer specified therein".

The terms and conditions of the letter of credit are strictly complied with by the exporter. Otherwise, the buyer's (importer's) bank has no obligation to take up the documents and make payment. The person applying for the letter of credit (buyer/importer) is called the applicant or opener. The person (seller/exporter) in whose name the letter of credit is opened is called 'beneficiary'. The bank issuing the letter of credit is called 'Issuing Bank' or 'Opening Bank'. The other bank in whose name the letter of credit is issued is called 'the advising bank'.

Parties to the Letters of Credit : In a letter of credit, there are different parties as stated below –

(i) **The applicant or opener :** A person, who makes an application and on whose behalf, the credit is opened/created is called the "opener of the letter of credit".

(ii) **The Beneficiary :** The beneficiary, namely the exporter or seller. The letter of credit is opened in his favour and addressed to him.

(iii) **The Issuing Bank or Opening Bank :** The issuing bank is the buyer's bank and it establishes the letter of credit on behalf of the opener.

(iv) **The Notifying or Advising Bank :** The correspondent bank which advises the credit to the beneficiary is called the notifying bank.

(v) **The Negotiating Bank :** The bank which negotiate the draft under the credit is called the negotiating bank. An exporter may negotiate the bill with any banker, then it is called Negotiating Bank.

3. Types of Letters of Commercial Credit : Letters of commercial credit may be sub-classified as follows :

(i) Documentary letter of credit and clean letter of credit;

(ii) Fixed credit and Revolving Credit ;

(iii) Revocable and Irrevocable letters of credit;

(iv) Confirmed and unconfirmed letters of credit ;

(v) 'With' and 'without' Recourse Letters of Credit ;

(vi) Transferable and non-transferable letters of credit ;

(vii) Back to back letter of credit ; and

(viii) Red-Clause letter of credit.

(ix) Clean letter of credit

(x) Revolving Letter of credit

(i) Documentary Letter of Credit and Clean Letter of Credit : It contains a clause that the title deeds viz. bill of lading, insurance policy etc., shall be attached with the bill of exchange.

(ii) Fixed Credit and Revolving Credit : In this case, the issuing banker specifies the amount upto which the beneficiary can draw within the specified time.

(iii) Revocable and Irrevocable Letters of Credit : Letters of credit may be revocable or irrevocable. If nothing is mentioned, the credit is deemed to be revocable.

(iv) Confirmed and Unconfirmed Letters of Credit : If the issuing bank requests the advising bank to add its confirmation to an irrevocable credit, it is called 'Confirmed or Irrevocable Letter of Credit'. If the advising bank does not add this confirmation, it is called 'unconfirmed letter of credit'.

(v) 'With' and 'without' Recourse Letters of Credit : Bills of exchange may be drawn under the letter of credit with recourse to the drawer or without recourse to the drawer. In case of former, if the bill is dishonoured, the banker (as the holder of the bill) can recover the amount from the drawer.

(vi) Transferable and Non-transferable Letters of Credit : Under transferable letter of credit, the beneficiary can transfer his right to draw a bill to somebody.

(vii) Back to Back Letter of Credit : When a beneficiary receives a non-transferable letter of credit, he may request a bank to open a new letter of credit in favour of some other person on the security of the letter of credit issued in his favour. It is called 'Back to Back Letter of Credit'.

(viii) Red-Clause Letter of Credit : Sometimes, the exporter/seller (beneficiary) may need credit from the advising bank for purchase of raw material etc. In order to enable the exporter to secure credit, a clause printed in red ink is inserted in the letter of credit. A Red Clause Letter of Credit contains an authority from the issuing banker to the advising banker to grant advances to the beneficiary upto a specified amount at the responsibility of the former (i.e. issuing banker).

(ix) Clean Letter of Credit : A clean or open letter of credit does not contain any such condition for payment to beneficiary (exporter). Under shipping documents they are not attached with the bill of exchange at the time of acceptance by the banker issuing letter of credit but sent by the exporter direct to the importer.

(x) Revolving Letter of Credit : If the amount of credit allowed under a letter of credits automatically renewed after the bills negotiated under it are fully honoured it is called a revolving letter of credit. The opening banker specified not the total amount upto which bills may be drawn, but the total amount upto which bills drawn remain outstanding at a time.

4. Advantages : The advantages of the letters of credit may be explained with reference to the following heads –

(A) Advantages to the Importer

(B) Advantages to the Exporter

(A) Advantages to the Importer :

(i) **Purchases without cash :** The purchaser can purchase goods on credit from foreign merchants who do not know him and may not rely upon his standing, on the banker's credit issuing the letter of credit.

(ii) **Payment after satisfying conditions :** The importer is assured in case of documentary letter of credit that the exporter cannot obtain any benefit under the letter of credit without actually shipping the merchandise and handing over the documents to the bank.

(iii) **Better terms of Trade :** The issuing banker lends the advantage of his own credit to the importer, who is able to secure better terms of trade, from the foreign suppliers which is otherwise not possible.

(iv) **Release against Trust Receipt :** When the bankers are willing to assume the credit risk of the importer, shipping documents are surrendered to him in return for his trust receipt and thus goods are released.

(B) Advantages to the Exporter :

(i) **Certainty of Payment :** Though the importer and the exporter are not known to each other, the letter of credit provides the letter an absolute assurance that the bills of exchange drawn under the letter of credit will be honoured.

(ii) **Exchange Security :** Possession of banker's letter of credit tends to eliminate, for the seller or the exporter, the risk of trade control or exchange control regulations in the country of the importer.

(iii) **Secure Loans :** The exporter can secure loans from his bank to buy or manufacturing the goods to be supplied on the strength of the letter of credit.

(iv) **Immediate Negotiation of Bill is possible :** The bills of exchange drawn under the letter of credit are readily discounted (Negotiated) with the advising or confirming banker or any other banker because of the firm undertaking given by the opening banker.

LECTURE VII
NATIONALISATION OF BANKS

This lecture covers –

1. Introduction

(i) The National Credit Council

(ii) Amendment of the Banking Regulation Act, 1949

(iii) Nationalisation of 14 banks

(iv) Nationalisation of 6 banks

2. Specialized institutions for financial assistance

3. Reasons for Nationalisation

4. Arguments in favour of Nationalisation

5. Arguments against Nationalisation

1. INTRODUCTION

Nationalisation is a process by which ownership and management is transferred from private individuals to the Government. The main object of the nationalization is, to serve better, the needs of economic development in consonance with national priorities and objectives. Its main aim is to render the largest good to the largest number of people (as laid down in *All India Bank Officers Confederation & others vs. Union of India and others, AIR 1989, SC 2045*). Nationalisation of banks envisages social control. The expression 'Social Control' in relation to banks and banking came into vogue since about December, 1967. There were several complaints that top priority, while sanctioning advances was given to the large and medium scale industries and priority sectors such as agriculture, small scale industries were denied.

Keeping in view the economic interests of the country also for safeguarding the interests of the depositors and also with the object of preventing the abuse of power by those controlling the banks, Banking Companies Act, 1949 was passed. The Act was passed to consolidate and amend them relating to the banking companies. By an Amendment, which became effective from 1st March, 1966, the name of the Act has been changed to the Banking Regulation Act, 1949.

On 14th December 1967 through a statement of the Minister of Finance in the Lok Sabha the Government sought to impose social control over the banks by taking two important steps –

Firstly, by setting up National Credit Council (also known as N.C.C.) and

Secondly, by introducing legislative controls by amending the Banking Regulation Act, 1949.

(i) The National Credit Council

The National Credit Council consisted of 25 members – 5 of them were permanent members. They included –

(i) The Finance Minister (he was Chairman of the N.C.C.)

(ii) Governor, Reserve Bank of India (he was its vice-chairman)

(iii) Deputy Chairman of the Planning Commission.

(iv) The Secretary of the Ministry of Finance and Deptt. Of Economic Affairs, and

(v) The Chairman of the Agricultural Refinance Corporation.

The remaining twenty members were also the Government appointees to secure adequate representation from various sectors, such as, commercial banks, cooperative banks, large and medium scale industries, agriculture, trade, exports, and it also included some economists and other experts.

The N.C.C. got dissolved by the nationalization of the commercial banks in 1970.

(ii) Amendment of the Banking Regulation Act, 1949

The element of social control was introduced in the banking system through an amendment in the Banking Regulation Act, 1949. The Preamble of the Amending Act 58 of 1968 reads as under –

"An Act further to amend the Banking Regulation Act, 1949, so as to provide for the extension of social control over banks and for matters connected therewith or incidental thereto, and also to further amend the Reserve Bank of India Act, 1934 and the State Bank of India Act, 1955".

The progressive nationalisation of banks has increased the role of public sector banking in the country. On July 19, 1969, the Government of India through an Ordinance nationalised 14 major commercial banks in the country, with deposits exceeding Rs. 50 crores each. Again on April 15, 1980, six more

commercial banks (now five because New Bank of India was merged with Punjab National Bank in September 1993) were nationalised. The State Bank of India and its seven subsidiaries had already been nationalised. The regional rural banks from their very inception are in the public sector. Thus about 90 per cent of the country's commercial banking system is now in the public sector.

(iii) Nationalisation of 14 Banks

Within 6 months of the imposition of social control over banks, the Government of India, by passing the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, nationalized the 14 major banks in India w.e.f. 19-07-1969. The 14 banks were –

1. The Central Bank of India Ltd.;
2. The Bank of India Ltd.;
3. The Punjab National Bank Ltd.;
4. The Bank of Baroda Ltd.;
5. The United Commercial Bank Ltd.;
6. The Canara Bank Ltd.;
7. The United Bank of India Ltd.;
8. The Dena Bank Ltd.;
9. The Syndicate Bank Ltd.;
10. The Union Bank of India Ltd.;
11. The Allahabad Bank Ltd,;
12. The Indian Bank Ltd.;
13. The Bank of Maharashtra Ltd.; and
14. The Indian Overseas Bank Ltd.

The nationalization of the 14 major commercial banks w.e.f. 19th July 1969 there was not only the change of ownership whereby the undertaking of the 14 major banking companies was vested in the corresponding new bank with deletion of the words 'The' in the beginning and the words 'Limited' at the end of their names, for instance 'The Central Bank of India Limited' was converted to 'Central Bank of India'. Further, by an amendment by the Banking Laws (Amendment) Act, 1985, United Commercial Bank was renamed 'UCO Bank'. This was done to avoid confusion in International transactions as there existed a bank named as 'United Commercial Bank' in Bangladesh as well.

Therefore by nationalization of these banks the ownership and control of these new banks vested in the Central Government. Each bank which was taken was paid compensation equivalent to the amount mentioned in the Schedule II of the Nationalising Act, 1970.

(iv) Nationalisation of 6 Banks : The Government of India nationalized 6 more banks on 15th April, 1980 by issuing an ordinance and passing of the Banking Companies(Acquisition and Transfer of Undertakings) Act, 1980, which came into force from 15th April, 1980. The 6 banks were –

1. The Andhra Bank Ltd.;
2. Corporation Bank Ltd.;
3. The New Bank of India Ltd.;
4. The Oriental Bank of Commerce Ltd.;
5. The Punjab & Sind Bank Ltd.; and
6. Vijaya Bank Ltd.

The management, functioning and control etc. of these banks is on the similar pattern as that of the 14 banks nationalized in 1969.

Further, with the nationalization of the State Bank of India and its seven subsidiary banks viz. State Bank of Saurashtra, State Bank of Patiala, State Bank of Indore, State Bank of Mysore, State Bank of Hyderabad, State Bank of Travancore and State Bank of Jaipur & Bikaner, there are 28 banks in India under the control of the Government of India.

2. SPECIALISED INSTITUTIONS FOR FINANCIAL ASSISTANCE

Since independence specialized institutions have been set up for financial assistance to different sectors like industries, agriculture and Rural Development, Imports & Exports and Housing Development, etc. They are as under –

1. Industrial Finance Corporation of India (IFCI)
2. State Financial Corporations (SFCs)
3. Industrial Credit and investment Corporation of India ltd. (ICICI)
4. Refinance Corporation for Industry Ltd
5. Industrial Development Bank of India (IDBI)
6. Industrial Reconstruction Bank of India (IRBI)
7. Agricultural Refinance and Development Corporation (ARDC)
8. National Bank for Agriculture and Rural Development (NABARD)
9. Agricultural Finance Corporation Ltd (AFC)

10. Export Import Bank of India (EXIM)
11. Export Credit Guarantee Corp. of India Ltd (ECGC)
12. Deposit Insurance & Credit Guarantee Corporation (DICGC)
13. Housing & Urban Development Corporation Ltd (HUDCO)
14. Housing Development Finance Corporation Ltd(HDFC)
15. National Housing Bank (NHB)
16. Discount and Finance House of India (DFHI)
17. Unit Trust of India (UTI)
18. General Insurance Corporation of India (GIC)
19. Life Insurance Corporation of India (LIC)

3. REASONS FOR NATIONALISATION

The government of India resorted to the nationalization of banks for the following reasons –

(i) To remove concentration of Economic Power.

(ii) Mobilisation of savings.

(iii) To curb malpractices.

(iv) To eradicate anti social elements

(v) Balance of Inter-regional development

(vi) Greater control by Reserve Bank of India and

(vii) Expansion of Banking Service.

(i) To remove concentration of Economic Power : Concentration of economic power in simple, means, centralization of wealth in few hands resulting in rich becomes richer and poor becomes more poor. Commercial banks under private sector allocate/advance funds to big industrial houses ignoring the priority sector. The main object of the nationalization of banks is to eradicate the concentration of economic power.

(ii) Mobilisation of savings : The main purpose of nationalization is to mobilize savings by establishing branches in rural areas so as to provide opportunity to people to make savings.

(iii) To curb malpractices : Nationalisation of banks aims to curb malpractices by banks under the private sector.

(iv) To eradicate anti social elements : There is a criticism that public funds (deposited in banks) are being misused by some anti-social elements. Nationalisation of banks paves way to prevent the intervention of such anti-social elements.

(v) Balance of Inter-regional development : There are great discrepancies between various regions in regard to credit-deposit ratio. Certain areas in the country remained backward due to lack of financial resources and credit facilities. Private banks neglected the backward areas. Nationalisation helps to provide bank finance in such a way as to achieve balanced inter-regional development and remove regional imbalances.

(vi) Greater control by Reserve Bank of India : In a developing economy like India, there is an acute need for exercising strict control over credit, created by banks. If banks are under State Control, it becomes easy for the Reserve Bank, to bring about co-ordinated credit control.

(vii) Expansion of Banking Service : Commercial banks under private sector have been proved to be a great failure in expanding the branches so as to serve more people and help in developing the economy of the nation.

4. ARGUMENTS IN FAVOUR OF THE NATIONALISATION

There had been a conflict of opinion as to the nationalization of banks. Some opined in favour, while the others opined against the nationalization.

The case for bank nationalisation in India is mainly based on the defective ownership biased credit deployment policy and unhealthy practices of the banks in the pre-nationalised period. The main arguments in favour of bank nationalisation in the country are as given below :

(i) Supporters of nationalization argue that nationalization promotes the efficiency of the banks. They opine that employees would work more and there will be good improvement in the turn out of the work in a day.

(ii) Another argument is that if the banks are under the control of private management, they will create credit indiscriminately with a view to earn more profits. This leads to inflation, where the money value will be lesser and it creates monetization problem. If the banks are under the State control it can be controlled according to the needs of the people.

(iii) One more argument in favour of nationalization is that, by nationalization of banks, credit policy of the banks and economy of the nation would be more effective.

(iv) Indian banks were owned and controlled by a few big shareholders. They generally influenced the pattern of allocation of bank credit in accordance with their own interests. According to an unpublished Reserve Bank sample survey, at the end of 1965, of the total equity capital of Rs. 21.4 crores of 91 large banks, about 40 per cent was held by only 33 accounts and the rest by more than 80000 accounts. The nationalisation of banks would bring banks under the control of the government for meeting the general interest of the public.

(v) The banks in India were controlled by a few industrial houses which use the public funds of the banks to build up huge industrial estates. According to an estimate, in mid-sixties, 70 per cent of the total industrial advances went to only one per cent of the total number of borrowal accounts, each with credit outstanding of over Rs. 5 lakh, whereas 12 per cent of the accounts with credit outstanding of less than Rs. 10,000/- each received only 4 per cent of the total. This led to the growth of wealth, and power in a few hands.

(vi) The resources of the banks were made available to the directors of these banks at concessional rates. These directors also had connections with other business concerns. According to an official survey, 188 persons serving on the Boards of 20 leading banks had 1452 directorships of other companies also. The interlocking of directorate is responsible for interlocking funds. Banks have connived with big business. In this way, the funds of the banks were not utilized for the economic development of the country but for the promotion of the interests of the directors. Bank funds are diverted for speculation. Bank nationalisation would check favourable attitude of the banks towards directors.

(vii) Indian banks had adopted a general policy of providing finance to large industries. Small businesses were not able to approach these banks for meeting their credit needs and were usually discriminated against. Nationalisation was favoured in order to extend financial help to the small business units.

(viii) Nationalisation will provide 100 per cent safety to the deposits of the people. This will inspire public confidence in the banking system and thus increase the bank deposits.

(ix) Nationalisation is essential to create socialist pattern of society.

5. ARGUMENTS AGAINST NATIONALIZATION

There had been a great opposition as to the nationalization of banks. The opponents argue that the nationalization took place within 168 days from the date of imposition of social control. The period is too short to judge the impact of nationalization.

The opponents also argued that there was no such pressing need as made out by government. The timing of the step was determined by political tussles and it was the result of inter-party struggle for power. They argued that a switch over to the public sector is not the only remedy for the evils revealed in the private sector; the process merely results in substitution of one group of evils for the other. The internal control of the Government is accompanied by equal or perhaps more harmful evils ; public sector institutions are known for their lack of dynamism.

The opponents also argued that the experience of public sector undertakings has not been happy. Public control leaves the door open for corruption and favouritism. Their performances are not always commendable. Their losses are heavy. The common man has a justifiable belief that public sector undertakings do not respect an individual and delays and lethargy in work and service are a bane of such undertakings. Particularly in a personalized service like banking these evils are likely to be more rampant.

Further, the nationalisation of banks is opposed for the following reasons-

(i) Nationalisation of banks results in decline in efficiency of the banks and gives room for political interference.

(ii) The root cause of the growth of monopolies and the concentration of wealth and power lies in the existing economic system. Therefore the remedy requires the changing and reforming of the economic system and not the nationalisation of banks.

(iii) Extending loans to agriculture and small scale industries is risky and less remunerative. Such loans are against the sound banking rules and may weaken the economic viability of these institutions.

Main objectives of Nationalisation : The statement of the objects and reasons of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 envisages that –

"The banking system touches the lives of millions and has to be inspired by a larger social purpose and has to subserve national priorities and objectives such as rapid growth of agriculture, small industries, exports, raising employment levels, encouragement of new entrepreneurs and development of backward areas."

The objectives outlined are :

(i) removal of control by a few;

(ii) provision of adequate credit for agriculture, small industry and exports;

(iii) giving professional bent to bank management;

(iv) encouragement of new class of entrepreneurs;

(v) provision of adequate training as well as reasonable service for bank staff.

Impact or consequences of Nationalisation : Remarkable changes have been witnessed after the nationalisation of the banks as summarized below –

(i) Several public sector banks and financial institutions became weak financially

(ii) SBI and its subsidiaries did not sustain losses. They made profits. The other 19 public sector banks continued to make losses.

LECTURE VIII
NEGOTIABLE INSTRUMENTS

(The Negotiable Instruments Act, 1881)

as amended by

The Negotiable Instruments (Amendment & Misc. Provisions) Act, 2002

This lecture covers –

1. *The Negotiable Instruments Act, 1881*
2. *Negotiable Instrument : Meaning & Definition*
3. *Features of Negotiable Instrument*
4. *Kinds of Negotiable Instruments*
   - *(A) Promissory Note (Sec.4)*
   - *(B) Bill of Exchange (Sec. 5)*
   - *(C) Cheque (Sec. 6)*
5. *Crossing of Cheques*
6. *Parties to the Negotiable Instrument*
   - *(A) Holder (Sec. 8)*
   - *(B) Holder in Due Course (Sec.9)*
   - *(C) Payment in Due Course (Sec. 10)*
   - *(D) Drawee in case of Need*
   - *(E) Holder for value.*
7. *Endorsement*
8. *Assignment and Negotiation*
9. *Kinds of cheques*
10. *Marking of Cheques*
11. *Material Alteration*
12. *Forgery of Customer's Signature*
13. *Notice of Dishonour*
14. *Criminal Liability of the Drawer of a Cheque (Cheque Bouncing)*
15. *The Paying Banker (Statutory Protection to the Paying Banker)*

16. The Collecting Banker (Statutory Protection to the Collecting Banker)

17. Closing of a Bank Account.

1. THE NEGOTIABLE INSTRUMENTS ACT, 1881

(As amended by the Negotiable Instruments(Amendment & Miscellaneous Provisions) Act, 2002)

The Negotiable Instruments are playing a vital role in the business world. The instruments which are transferable by delivery or by endorsement and delivery may be called negotiable instruments e.g. Promissory Notes, Cheques, Bills of Exchange etc. The law relating to Negotiable Instruments in India is governed by the Negotiable Instruments Act, 1881 (As amended by the Negotiable Instruments(Amendment & Miscellaneous Provisions) Act, 2002). It is originated from the English Common Law and is borrowed from the English Legislations relating to the negotiable instruments viz. the Bills of Exchange Act, 1882. The Negotiable Instruments Act was passed in 1881 and came into force from 1st March 1882. It extends to the whole of India (The Words "Except the State of Jammu & Kashmir" omitted by Act 62 of 1956 under Section 2 and Schedule w.e.f. 01.11.1956), but nothing herein contained affects the Indian Paper Currency Act, 1871.

The Negotiable Instruments Act contains 147 Sections divided into 17 Chapters and Schedule (repealed by the Amendment Act, 12 of 1891). Chapter I containing sections 1 and 2 contains preliminary aspects. Section 1 contains title, extent and applications. Section 3 contains Interpretation clause and defines the term Banker (Sec. 2 : Repeal of enactments). Chapter II containing sections 4 to 25 lays down the provision relating to "Notes, Bills and Cheques". Chapter III containing sections 26 to 45 deals with "parties to Notes, Bills and Cheques". Chapter IV containing sections 46 to 60 lays down the provisions relating to 'Negotiation'. Chapter V containing sections 61 to 77 lays down the provisions of presentment. Chapter VI containing sections 78 to 81 makes provisions relating to Payment and Interest. Chapter VII containing sections 82 to 90 provides the provisions relating to "Discharge from liability on Notes, Bills and Cheques". Chapter VIII containing sections 91 to 98 deals with "Notice of Dishonour". Chapter IX containing sections 99 to 104 lays down the provisions of Noting and Protest. Chapter X containing sections 105 to 107 makes provisions of "Reasonable Time". Chapter XI containing sections 108 to 116 deals with "Acceptance and Payment for Honour and Reference in case of Need". Chapter XII containing section 117 makes provisions of compensation. Chapter XIII containing sections 118 to 122 provides for "Special Rules of Evidence". Chapter

XIV containing sections 123 to 131A contains provisions of crossed cheques. Chapter XV containing sections 132 and 133 contains provisions of "Bills of Sets". Chapter XVI containing sections 134 to 137 contains provisions of "International Law" and finally Chapter XVII containing sections 138 to 147 lays down the provisions of "Penalties in case of dishonour of certain cheques for insufficiency of funds in the accounts".

2. NEGOTIABLE INSTRUMENT : MEANING & DEFINITION

Meaning : The expression "Negotiable Instrument" means a piece of paper in writing entitling a right to the holder, a certain sum of money". It is a piece of paper, which contains some value and is transferable by simple delivery or sometimes by endorsement and delivery. According to Sec 13(1) of the Negotiable Instruments Act, a negotiable instrument means a promissory note, bill of exchange or cheque. Under the Law of Negotiable Securities, an instrument possessing the quality of negotiability is entitled to be called a negotiable instrument.

Eg. Cheque, Demand Draft, Promissory Note, Bill of Exchange, Share Warrants, Dividend Warrants, Bearer Debentures etc.

According to Thomas an instrument is negotiable when

(i) The instrument is freely transferable (by delivery or endorsement and delivery) either by application of law or by the custom of the trade concerned and

(ii) Confers the privilege on the person who receives it bonafide and for value to possess good title thereto.

The Act states only three instruments – cheques, bills of exchange and promissory note- as negotiable instruments. Hence they are called negotiable instruments by statute.

Some other instruments have acquired the feature of negotiability by the custom or usage of trade. Section 137 of Transfer of Property Act, recognized that an instrument may be negotiable by law or custom. In our country therefore Government Promissory Notes, Shah Jog Hundis, Delivery Orders and Railway Receipts have been held negotiable by usage or the custom of trade.

There are several instruments which are not negotiable but can be transferred by delivery or endorsement and delivery. Yet they cannot confer a better title on the transferee than what the transferor has.

Definition : Negotiable Instrument has not been defined under the Negotiable Instruments Act. According to section 13 of the Act "a negotiable instrument means a promissory note, bill of exchange or cheque payable to order or bearer, whether the words order or bearer appears on the instrument or not".

In England Justice K.C.Wallis defines a negotiable instrument as "one, the property in which is acquired by anyone who takes it bonafide and for value, not withstanding any defect of title of the person from whom he took it."

According to Bhashyam and Adiga (in his "Negotiable Instruments Act, 1881) " A Negotiable Instrument is one, which when transferred by delivery or endorsement and delivery passes to a transferee a good title to payment according to its tenor and irrespective of title of the transferor".

According to Thomas (in his Principles of Banking) " a Negotiable Instrument is one which is by a legally recognized custom of trade or law, transferable by delivery. In such circumstances that :

(a) the holder of it for time being may sue on it in his own name and

(b) the property in it passes free from equities, to a bonafide transferee for value, not withstanding any defect of the transferor ".

By observing the above definitions we can deduce the following features of Negotiable Instrument.

(i) Negotiability

(ii) It confers absolute and good title to the Transferee.

(iii) the holder can recover the money with his own name and

(iv) it consists certain presumptions.

3. FEATURES OF NEGOTIABLE INSTRUMENT

Following are the characteristic features of the Negotiable Instruments –

(i) Transferability

(ii) Absolute Title and

(iii) Right to Sue.

(i) Transferability : The negotiable instruments are easily transferable from one person to another by mere delivery in case of a bearer instrument and by endorsement and delivery in case of an order instrument.

(ii) Absolute Title : A negotiable instrument confers absolute and good title on the transferee, who takes it in good faith, even though the transferor and

defective title. Such person (transferee) is called 'holder in due course' and his interest in the instrument is protected by law.

(iii) Right to Sue : The holder of a negotiable instrument, who is legally called as 'holder in due course' has a right to sue upon the instrument in his own name.

4. KINDS OF NEGOTIABLE INSTRUMENTS

Following are the different kinds of negotiable instruments :

(A) Promissory Note (Sec.4),

(B) Bill of Exchange (Sec. 5) and

(C) Cheque (Sec. 6).

(A) Promissory Note (Section 4)

Definition : Section 4 of the Negotiable Instruments Act, 1881 defines promissory note as "an instrument in writing (not being a bank note or currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument". In short, it is called 'Pronote'.

The promissory note contains a promise or undertaking to pay a certain sum of money. The Act does not prescribe any particular form for a valid promissory note, but it is essential that it must satisfy the requirements of Section 4.

Essentials : A promissory note to be valid and enforceable, the following essentials are to be satisfied :

(i) The promissory note must be in writing ;

(ii) It must contain a promise/undertaking to pay certain sum of money ;

(iii) The promise must be unconditional and certain ;

(iv) It must be duly signed and delivered by the maker ;

(v) The parties must be certain ;

(vi) It must be stamped according to the provisions of the Stamp Act, 1940.

(i) The promissory note must be in writing : Object of this requirement is to exclude oral engagements to pay from the purview of the Act. But it is immaterial whether the writing is in ink or in pencil. The term 'writing' includes printing, engraving, lithographing, typewriting etc. There is no prescribed form for validity of promissory note provided the requirements of the definition are complied

with. Further the writing may be on any material – paper, parchment, account book, etc.

(ii) It must contain a promise/undertaking to pay certain sum of money : It must not be a mere acknowledgement of debt without an express promise to pay. An instrument to be valid promissory note must have an undertaking to pay a sum. Thus the writing "I owe you Rs. 500", "I am liable to pay" or "I am bound to pay", constitutes only acknowledgements of liability to pay and cannot be treated or dealt with as promissory note.

I promise to pay Rs. 5000/- three months from this day to Mr. Manmohan or bearer or order for value received. This is the correct form of promissory note as it clearly expresses the promise to pay.

(iii) The promise must be unconditional and certain : A promissory note must contain an unconditional undertaking to or promise to repay. The payment of money should not be made to depend upon contingency, certainty is absolutely necessary in the commercial world. A conditional instrument will not be negotiable even after the fulfillment of the condition.

An instrument which contains, "I promise to pay C Rs. 100 on the 31st December 1940, provided the war ends towards the end of November 1940", cannot constitute a promissory note, as it does not contain an unconditional undertaking to pay the sum mentioned therein. But a promise to pay B Rs. 500 one month after the death of C is a valid promise because death is a certainty. So it is an unconditional promise.

(iv) It must be duly signed and delivered by the maker : The promissory note is incomplete without the signature of its maker. The object of the signature is to authenticate and give effect to the contract contained in the document. This signature can be made in any part of the document. This may be done even with a pencil. If the maker cannot write his name he may sign by thumb mark.

(v) The parties must be certain : It is of utmost importance that the promissory note should point out with certainty the person who enters the contract and engages or undertakes to pay. Several persons may make a promissory note jointly and severally. Where a promissory note is drawn in the form "I promise to pay" and is signed by two or more persons it is deemed to be their joint and several note.

But a promissory note cannot be made in alternative form. Thus a promissory note running as "I.A.B. promise to pay" and signed by "A.B. or else C.D." is not a good note as regards C.D. but is a good note as against A.B.

(vi) It must be stamped according to the provisions of the Stamp Act, 1940.

Specimen/Format of Promissory Note

(a) When promise is made to pay money on demand

Rs. 20000 Pune,

September, 18, 2007

On demand, I promise to pay Sri. Gupta or order the sum or Rupees Twenty Thousand only for value received with interest at 12 per cent per annum.

To,

Sri. Gupta

148, Shivajinagar,

Pune-01

Stamp

Sd. Ram

(b) Where promise to pay money after the expiry of a fixed time.

Rs. 20000 Pune,

September, 18, 2007

Three months after date I promise to pay Sri. Gupta or order the sum or Rupees Twenty Thousand only for value received.

To,

Sri. Gupta

148, Shivajinagar,

Pune-01

Stamp

Sd. Ram

(B) Bill of Exchange (Section 5)

A bill of exchange is written and signed order directing the person named in it to pay a certain sum of money only to, or to the order of a certain person or to the bearer. Bills of exchanges arise in business transactions. They normally arise

when goods are sold on credit. The seller (creditor) draws bill on the buyer (debtor or buyer) to pay the amount specified in the bill of exchange normally after a specified period of time. The title of the bill of exchange can be transferred by endorsement and delivery/delivery or it can be discounted with a banker. It can also be sent to a banker for collection.

According to Section 5 of the Act, "a bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only or to the order of a certain person, or to the bearer of the instrument".

In a bill of exchange one person makes an order to another person to pay a certain sum of money to someone. A bill of exchange is different from a promissory note in so far as in a promissory note there is a promise made by the maker of a promissory note to pay a certain sum of money whereas in a bill of exchange there is an order to pay. The other requirements in a bill of exchange are similar to those in the case of a promissory note. In a bill of exchange the order should be unconditional, it must be to pay money only, the sum payable should be certain, the instrument should be in writing and signed by the person who makes it and the payee should also be certain.

Where the instrument must be construed either as a promissory note or bill of exchange, the holder may at his election treat it as either, and the instrument shall be thenceforward treated, accordingly.

Essentials : Following are the essential elements of a bill of exchange.

(i) It must be in writing.

(ii) It must contain an order or undertaking to pay certain sum of money.

(iii) The order to pay must be unconditional.

(iv) There are three parties viz. Drawer, Drawee and Payee.

(v) It must be signed by the drawer.

(vi)The sum payable must be certain.

(vii)It must be stamped according to Stamp Act, 1940.

Specimen/Format of Bill of Exchange

Rs. 25,000/- Mumbai,
September 27, 2007

Three months after date pay to X or order the sum of Twenty Five Thousand Rupees for value received.

To, Z Accepted Sd/- Y Stamp
Z

Kinds of Bills of Exchange : The Bills of Exchange may be classified as follows:

(i) Inland and Foreign Bills.

(ii) Time and Demand Bills.

(iii) Trade Bill and Accomodation Bill.

(iv) Clean Bill and Documentary Bill.

Distinction between Promissory Note and Bill of Exchange : Despite many similarities, there are certain differences between the two as stated below.

	Promissory Note	**Bill of Exchange**
(i)	There are two parties namely Maker and Payee.	(i) There are three parties namely, Drawer, Acceptor and Payee.
(ii)	The Maker of Pronote is Debtor	(ii) The Maker is Creditor.
(iii)	Maker and Payee cannot be the the same person.	(iii) The Drawer and payee may be the Same person.
(iv)	It is an unconditional promise.	(iv) It is an unconditional order.
(v)	Cannot be payable to bearer.	(v) Can be payable to bearer.
(vi)	Pronote cannot be drawn in sets.	(vi) Bill can be drawn in sets.

(C) Cheque (Section 6)

Dr. Hart, in his Law of Banking defines a cheque as 'an unconditional order in writing drawn on a banker signed by the drawer, requiring the banker to pay on demand a sum certain in money to or to the order of a specified person or bearer and which does not order any act to be done in addition to the payment of money'.

A cheque is also a bill of exchange with two additional features :

(i) It is always drawn on a specified banker.

(ii) It is always payable on demand.

Section 6 of the Negotiable Instruments Act, 1881 defines cheque as "a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes electronic image of a truncated cheque and a cheque in the electronic form".

The definition of the cheque has been enlarged by the Negotiable Instruments (Amendment) Act, 2002 so as "to include electronic image of a truncated cheque and a cheque in the electronic form".

Cheque can be signed using digital signature and asymmetric crypto system.

A cheque is a bill of exchange with the following distinctive features :

(i) It is always drawn on some bank. It means that the drawee of a cheque is always a bank.

(ii) A cheque is always payable on demand. A bill of exchange other than a cheque may be either payable on demand or may not be payable on demand.

(iii) After the amendment of the act in 2002, a cheque may also be in "electronic form".

Elements : Cheque is a special kind of bill of exchange, and the essentials of bill of exchange are also present in respect of the cheque. Further, to constitute cheque, the following conditions are to be satisfied -

(i) It must be drawn on a specified banker, and

(ii) It is always payable on demand.

Form of Cheque : A cheque can take the form of an order written on an ordinary piece of paper, but bankers usually insist upon the use of printed cheque forms supplied by them to their customers. A cheque is not invalid simply because

it is made on an ordinary slip of paper, but usually the rules for opening an account specify that the customers should make use of printed cheque forms only. It is by virtue of such a rule that the banker would be justified in dishonouring cheques not drawn on the printed forms supplied to customers.

Specimen of Cheque

State Bank of India

Main Branch, Eluru (A.P.)

Date: 15/01/2008

Pay to.....X.....or bearer/order

Rupees.....Ten Thousand only.....

Rs. 10,000/-

A/c No.....

Sd/- X

No. 690786

Cheques need not be stamped : In *C.T. Joseph v. I.V. Phillip (A.I.R. 2001, Ker. 300)* it has been held by the Kerala High Court that the cheques do not require any stamp under the Stamp Act. It has also been held that Section 20 of the Negotiable Instruments Act, which applies only to inchoate instruments, does not apply to cheques.

It may be noted that in practice in case of certain payments like payment through treasury such as Income Tax refund orders, it is insisted that there should be acknowledgement of receipt of the amount and the necessary stamp is also required on the back of the Refund Order.

Period of validity of a cheque : A cheque is valid for payment within a period of six months from the date on which it is drawn. According to the banking practice a cheque remains valid for payment for six months from the date on which it is drawn. Thereafter it becomes stale and then the drawee bank can

refuse to pay the same.

Sometimes the drawer mentions a period of less than 6 months for which the cheque is to remain valid. For instance, there may be a mention "valid for 3 months only". In such a case the validity period of the cheque would be 3 months from the date of its issue. Similarly, for example, a cheque dated 1st January may mention "Valid upto 30th April". Then the validity of the cheque will be upto the specified date.

Revalidation of stale cheque : A cheque which has become stale by the expiry of the period of validity can be revalidated by the drawer. A revalidated cheque gets a new lease of life and remains valid for the extended period of validity.

Validity of a post-dated cheque : In case of post dated cheque the period of validity is to be counted from the date which has been put on the cheque because that date is to be considered as the date of issue of cheque rather than the date on which the cheque has been drawn (*Shri. Ishar Alloys Steel Ltd v. Jayaswala NECO Ltd., AIR 2001 S.C. 1161*).

A post dated cheque is not a cheque on the date on which it is drawn. It becomes a cheque on the date written on it and till that date the instrument remains a Bill of Exchange *(Ashok Yeshwant Badave v. Surendra Madhavrao, AIR, 2001 SC 1315).*

For the purpose of offence of dishonour of cheque the pre-requisite is presentation of the cheque within 6 months from the date it is drawn. Thus, the period of 6 months for the post dated cheque starts from the date written on the cheque.

Distinction between bill of exchange and cheque

Bill of Exchange	Cheque
(i) The drawee may be any person including a banker.	(i) Drawee is always a banker.
(ii) Acceptance of drawee is necessary.	(ii) Not necessary.

(iii) Notice of dishonour is necessary.	(iii) Not necessary.
(iv) Drawee is not entitled to any statutory protection.	(iv) Drawee is entitled to Statutory protection.
(v) Grace period of 3 days for payment is allowed.	(v) No such grace period for Payment.
(vi) It has to be stamped according to Stamp Act, 1940.	(vi) Stamping is not necessary.
(vii) No crossing is allowed.	(vii) Different kinds of crossing is allowed.
(viii) Payment of bill cannot be stopped or countermanded.	(viii) Paymentof a cheque can be Countermanded.

5. CROSSING OF CHEQUES

Chapter XIV containing sections 123 to 131 of the Negotiable Instruments Act, 1881 lay down the provisions relating to crossing of cheques.

Cheques may be classified into two categories namely,

(i) Bearer or open or counter cheques, and

(ii) Crossed cheques.

Bearer cheque can be encashed directly through the counter while the crossed cheque can be cashed only through a bank account.

(i) Bearer Cheque : The word 'bearer' is not defined in the Negotiable Instruments Act, but, the Bill of Exchange Act explains that 'bearer' means "the person in possession of a bill or note which is payable to bearer". It means, the instrument can be made originally payable to the bearer or it may be made bearer subsequently by holder making a blank endorsement. The bearer character of the instrument will not be lost, even in those cases where a bank endorsement is followed by full endorsement. The instrument continues to be transferable by mere delivery in all such cases (*Walker v. Macdonble (1948) 26. 527*). With regard to bearer cheques the rule is "once a bearer cheque always a bearer cheque". Where a cheque is originally expressed by the drawer himself to be payable to the bearer, the paying banker is fully protected if he makes the payment to the bearer or even if there is any forged or restrictive endorsement on the cheque. But the payment must be a payment in due course.

The banker is not required to verify endorsements on cheques drawn payable to bearer because a bearer cheque does not require endorsement for the purpose of negotiation but only delivery. However, in practice banks in India insist upon the presenter's signing the cheque presented over the counter before payment is made. Such a signature, besides operating as a receipt may even perhaps help the bank later in identifying the person to whom payment was made.

This principle of 'once a bearer always a bearer' has been introduced in Sec. 85(2) of the Negotiable Instruments Act by way of an Amendment to the Act in 1934. It says :

"Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the payee thereof, notwithstanding any endorsement whether in full or blank appearing thereon, and not withstanding that any such endorsement purports to restrict or exclude further negotiation".

The Mumbai High Court held that before the amendment was passed a bearer cheque could be converted into an order cheque by endorsement (*Dossabhai vs. Virchand (1969) 21 Bom. A.G.*). C.J. and Kineain J. held that where a hundi was drawn in favour of a payee or bearer and the payee endorsed it to a named person, it ceased to be a bearer hundi and could be negotiated further only by the endorsee (*Forbes Cambell & Co. vs. The official Assignee, Bombay (1925) 27 Bom. L.R. 34*). These two decisions have been nullified with the introduction of Sec. 85(2) in Negotiable Instruments Act by the Amendment of 1934.

Sec. 85(2) has no application to the (i) Payment of a cheque which becomes bearer by a subsequent endorsement in blank, and (ii) Payment of a customer's bill of exchange or promissory notes.

(ii) Crossed Cheques : A crossed cheque is one which has two transverse parallel lines, marked across its face, with or without the words 'and company' or any abbreviation thereof. Crossing is an instruction from the drawer to the paying banker to pay the amount of a cheque through bank only and not directly to the person presenting it at the counter.

Crossing may be hand-written, stamped, printed or perforated. Crossing does not effect the negotiability of the instrument. Therefore, a crossed cheque is negotiable by delivery in case it is payable to bearer and by endorsement and delivery where it is payable to order. A crossed cheque can only be encashed through bank of which the payee of a cheque is a customer. The holder of a cheque who has no account can also obtain the amount by endorsing in favour of some person who has got an account with the banker. The relevant rules regarding the crossing are given under sections 123 to 131 of N.I.Act.

Kinds of Crossing : Crossing of cheques is of two kinds namely –

(i) General Crossing ; and

(ii) Special Crossing

(i) General Crossing (Sec. 123) : Section 123 deals with "General Crossing". It runs as follows :

"Where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words "not negotiable", that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally."

General crossing consists in drawing of two parallel transverse lines on the face of the cheque. Some times, in addition to these lines, the words "and company" or '& co.' or 'Not Negotiable' or 'Account Payee' may be added as shown below :

Writing of two parallel transverse lines on the face of the cheque are essential for general crossing and the inclusion of words 'and company' or '& co. is immaterial. The lines should normally be drawn, across the middle of a cheque but sometimes they run across a corner, usually the left hand top corner. The Act is silent as regards the size of the lines or the distance between them.

(ii) Special Crossing (Sec. 124) : Section 124 of the Negotiable Instruments Act, 1881 lays down the provisions relating to "Special Crossing". It reads as follows –

"Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable", that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker."

Special Crossing consists in writing, the name of the bank across the face of the cheque. In special crossing, the banker on whom it is drawn shall pay it otherwise than to the banker to whom it is crossed or his agent for collection. Specimen of special crossing is given below :

Section 126 of the Act imposes an obligation on the paying banker to make payment against crossed cheques. Otherwise he is liable under section 129 of the Act. Further, he loses statutory protection available to paying banker under section 128.

A special crossing requires the name of the banker to be written across and on the face of the cheque. The two parallel transverse lines are not necessary for

a special crossing although they are usually drawn, or also the words '& Co.' or their abbreviations since special crossing itself specifies the name of the banker.

A cheque crossed specially will be paid only when it presented by the bank named between the parallel lines. The banker to whom the cheque is specially crossed, may appoint another banker as his agent for collection of such cheques. Thus, a special crossing makes the cheques still more safe.

Who may cross a cheque (Sec. 125) : A cheque may be crossed either by the drawer or by the holder. Section 125 permits the crossing being made in the following ways by the holder :-

(i) Where a cheque is uncrossed, the holder may cross it generally or specially.

(ii) Where a cheque is crossed generally the holder may cross it specially.

(iii) Where a cheque is crossed generally or specially the holder may add the words "not negotiable".

The banker also is entitled to cross a cheque in the name of another bank who may collect the cheque as an agent for collection. Therefore, where a cheque is crossed specially, the banker to whom it is crossed may cross it specially to another banker, his agent for collection (Section 127).

Protection to the "Paying Bank" (Sec. 128) : The relation between a banker and his customer is that of a debtor and a creditor. Banker does not enjoy the position of a trustee of the money deposited with him by the customer. Money deposited will always belong to the customer and the bank will be bound to return its equivalent to the customer or to any person to his order on demand. Section 31 of the Negotiable Instruments Act provides "the drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque must pay the cheque when duly required to do so, and in default of such payment, must compensate the drawer for any loss or damage caused by such default." Thus a banker should be very cautious both at the time of honouring as well as dishonouring his customer's cheques.

The paying banker shall ensure that the cheque which is presented for payment is in order in all respects before making payment of cash. Sec. 126, 127 and 129 of the Negotiable Instrument Act lays down the duties of paying banker as regards to crossed cheques.

Sometimes the collecting bank may collect the cheque for a person who is not actually entitled to receive the payment. The paying bank may not be aware

of the fact and the responsibility of the paying bank ends when it makes the payment to the collecting bank because the collecting bank is in a better position to know as to for whom the collection is being made. According to section 128 when the paying bank, i.e. that bank on whom the crossed cheque is drawn makes the payment of the cheque in due course it is deemed to be valid payment as if the payment had been received by the true owner of the cheque. The protection is available to the paying bank only if the payment has been made in due course, as defined in section 10 i.e. the payment in good faith, without negligence, according to the apparent tenor of the negotiable instrument. Thus, if the paying bank makes the payment of an "Account Payee" cheque to the collecting bank on an endorsement by the latter bank stating "payee's account credited", the paying bank is protected under section 128, even if the collecting bank negligently credits the account of a person other than the payee (*Anupama Stationery v. Vishnuvardhana Enterprises, (1987) 62 Comp. Cas. 271(Karn)*.

If the drawee bank makes payment out of due course then it would be liable for the loss suffered by the true owner of the cheque (section 129). For example, if a cheque is crossed generally and the bank makes the payment at the counter or it is crossed specially to a particular bank and the payment is made to another bank, such payment is not in accordance with the apparent tenor of the cheque and it is not a payment in due course. In such a case the drawee bank can be held responsible for any loss which the true owner might sustain owing to the cheque having been so paid.

Precautions to be taken by a Paying Banker : The paying banker, while honouring the cheques shall take the following precautions –

(i) The cheque should be in proper form. The Negotiable Instruments Act does not give the form of a cheque but most banks in India provide in their rules of operating accounts that the cheque must be drawn in the printed forms supplied by the banks and the banks reserve the right of dishonouring a cheque in case it is not in the prescribed form.

(ii) The most important precaution that a banker should take is about crossed cheque. A banker has to verify whether the cheque is open or crossed. He should not pay cash across the counter in respect of crossed cheques. If the cheque is a crossed one, he should see whether it is a general crossing or special crossing. If it is a general crossing, the holder must be asked to present the cheque through some banker. It should be paid to a banker. If the cheque bears a special crossing, the banker should pay only to the bank whose name is mentioned in

the crossing. If it is a open cheque, a banker can pay cash to the payee or the holder across the counter. If the banker pays against the instructions as indicated above, he is liable to pay the amount to the true owner for any loss sustained. Further, a banker loses statutory protection in case of forged endorsement.

In Madras Bank Ltd Vs. South India Match Factory Ltd., a ;cheque was issued by a purchaser in favour of the official liquidator of a company towards the purchase price of certain properties. The bank paid the amount of the crossed cheque to the liquidator across the counter. The Liquidator mis-appropriated the amount. In a suit filed, the court held that the "banker committed breach of statutory duty and was negligent in paying direct to the liquidator over the counter and hence was not entitled to legal protection."

(iii) He must verify that whether the cheque presented for payment is properly dated. If it is undated or postdated or stale(i.e. dated earlier than 6 months), he should dishonour the cheque.

In case a banker honours a post-dated cheque, it runs the following risks :

(a) The drawer may countermand the payment before the date mentioned on the cheque and then the banker will not be entitled to debit the customer's account with the amount of the cheque.

(b) The drawer may make the banker liable for dishonouring of other cheques on account of insufficiency of funds resulting because of payment of the post-dated cheque.

(c) In case of insolvency or death of the drawer before the date mentioned on cheque, the banker shall not be entitled to debit the customer's account, if it has already made payment of the cheque.

(d) The payment of a post-dated cheque shall not be considered to be a payment in due course and, therefore, the banker shall not be entitled to any statutory protection if the payment is made to a wrong person.

(iv) The banker should see that the amount mentioned both in figures and words in the cheque are the same. In case they differ, the amount stated in words may be taken as correct and the banker returns the cheque for reference to the drawer. In case the amount has been stated in words only and not in figures the banker should pay the cheque.

But where the amount has been mentioned in figures only, not in words, the banker should return the cheque.

(v) There should be sufficient funds in the account of the customer for payment of the cheque. Cheque has to be paid in full and not in part and, therefore, inadequacy of funds will result in dishonour of the cheque unless the banker has granted loan or advance to the customer to that extent or more than the amount of deficit.

(vi) He must check the drawer's signature got tallied with the specimen signature of the drawer in the bank records.

(vii) He should pay during banking working hours open to the public.

(viii) He should dishonour the mutilated cheques (i.e. cheque, which is torn into two or more pieces).

Protection to the "Collecting Bank" (Sec. 131) : A banker is under no legal obligation to collect cheques and bills on behalf of its customers. But every modern bank collects cheques and bills on behalf of its customers in order to provide a service to them. This service of collection of cheques on behalf of its customers has become an accepted part of banker's functions, due to greater use of crossed cheques, which are payable through a banker only. When a banker undertakes to collect cheques and bills, he is called "collecting banker". In the process of collecting cheques the banker acts as a (i)holder for value, (ii) as an agent of the customer. A collecting banker has certain duties and responsibilities in collection of cheques for his customer.

Section 131 of the Act grants a protection to the collecting bank. If the collecting bank has collected a cheque satisfying the conditions which are mentioned in Section 131, then it cannot be held liable even if the amount is collected on behalf of a person who is not the true owner. In order to avail of such a protection the banker has to prove the following:

(i) That the banker had received the payment as a crossed cheque. It means that the cheque which is to collect must have been given to the banker as crossed i.e., which was crossed either generally or specially to that banker before it reached the hands of the collecting bank.

(ii) That the collection was made by the bank on behalf of a customer. It is however immaterial that the bank may credit the customer's account before the amount is collected.

(iii) The collecting bank must have acted in good faith and without negligence in collecting the amount due on the cheque. If there are circumstances which can arouse a suspicion in the mind of a collecting bank regarding the rights of a person who wants to get the cheque collected the bank is supposed to make proper inquiries before collecting the cheque. If the bank fails to make any such enquiry, it is not acting in good faith.

(iv) It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the prima facie genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care.

In *Anupama Stationery vs. Vishnuvardhana Enterprises (1987) 62 Comp. Cas. 271 (Karn.)*, the collecting bank collected a cheque marked "payee's account only" by making an endorsement, "payee's account credited". It however, negligently credited the account of a person other than the payee. The collecting bank was held liable to pay damages to the drawer of the cheque.

If the bank is negligent in opening the account in a fictitious name, and is subsequently negligent in collecting the cheque/draft, the bank cannot claim the protection under Section 131.

In *Syndicate Bank vs. Jayshree Industries (AIR, 1994 Kant. 315)*, a draft in the name of 'Ms. Rama' was collected and credited to the account of 'Mr. Rama', the bank was held to be negligent and thus not entitled to protection given under Section 131, N.I. Act. It is no defence that the bank acted in good faith.

Negligence in collecting a Bank Draft or a cheque includes, negligently opening a Bank Account of a person and then collecting his Bank Draft negligently for him.

6. PARTIES TO THE NEGOTIABLE INSTRUMENT

A negotiable instrument is transferable from one person to another. The Negotiable Instruments Act 1881 confers upon a person who acquires the instrument bonafide and for value, the right to possess good title to the instrument. Such a person is called 'holder in due course'. Each and every person in possession of a cheque or bill can not be holder in due course and therefore cannot claim statutory protection under the Act. If the instrument falls into wrong hands, the holder cannot enjoy the privileges of a holder in due course. The parties to the Negotiable Instrument may be explained with reference to the following heads -

(A) Holder (Sec. 8)

(B) Holder in Due Course (Sec.9)

(C) Payment in Due Course (Sec. 10)

(D) Drawee in case of Need

(E) Holder for value.

(A) Holder (Sec. 8)

Holder (Section 7) : According to section 8 of the Negotiable Instruments Act, 1881 the "holder of promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto."

In simple words, holder means 'owner of the negotiable instrument'. A person to be a holder must satisfy the following conditions :

(i) He should be entitled in his own name, to the possession of the instrument; and

(ii) He should have the right to receive or recover the amount due thereon from the parties thereto.

In case of bearer instrument, the possessor is the holder while in the case of an instrument payable by order, the payee is the holder.

If a person is entitled to the possession of a negotiable instrument in his own name he will be the holder. What is required is a right to possession. A person in possession of an instrument without having a right to possess the same cannot be called the holder. Thus, a thief or a person taking a negotiable instrument by forged endorsement or a person finding an instrument on the road, although may be having a de facto possession but he cannot be called the holder, because his possession is wrongful and he is not entitled to the possession of the negotiable instrument. Similarly, if I deliver a negotiable instrument to my servant for safe custody he does not become the holder because he is not entitled to the possession in his own name. Holder, therefore, means only a "De Jure holder" and not merely a "De facto holder".

When a negotiable instrument is originally made, the payee is the holder of the same. If the payee transfers his rights to another person then the transferee becomes the holder in place of the payee. In the case of a Bearer instrument the transferee to whom the negotiable instrument is delivered is known as the 'Bearer' of the instrument and such transferee (bearer) is the holder. In the case of an order

instrument the instrument is transferred by an endorsement and delivery to the endorsee, in such a case the 'endorsee' becomes the holder. Thus, the term holder would include the following :

(i) The Payee.

(ii) The Bearer (i.e. the transferee of a bearer instrument), or

(iii) The Endorsee (i.e. the transferee of an order instrument).

(B) Holder in Due Course (Sec.9)

A holder in due course is in a privileged position and has a good title, though the transferor has a defective title.

According to section 9 of the Negotiable Instruments Act, 'holder in due course' means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order before the amount mentioned in it became payable (and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived the title).

Example : When a person has obtained a negotiable instrument by theft of fraud or for an unlawful consideration, the title of the person having such possession is defective. If he transfers it to a holder in due course, the title of the holder in due course is good. If he further transfers, such transferee's title also is good. Therefore, according to section 36 of the Negotiable Instruments Act, every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied (prior party in the sense, maker of promissory, drawer of bill of exchange or cheque, the drawee or acceptor of a bill and endorsers of the instrument)

Conditions : A person to be a holder in due course, the following conditions are to be satisfied.

(i) He must have received the instrument for a valuable consideration.

(ii) The instrument should be obtained before its maturity.

(iii) The instrument should be complete and regular on its face.

(iv) He should have taken the instrument in good faith (without the knowledge of defective title).

Rights and Privileges : The Negotiable Instruments Act, confers on the holder in due course, the following rights and privileges :

(i) A holder in due course, prima facie must be a holder of the instrument for a valuable consideration. It is an exemption to the maxim "nemodat quod non-habet."

(ii) Section 58 provides another privilege to a holder in due course. When a negotiable instrument has been lost or has been obtained by a person by means of an offence, say theft, or by fraud, or for an unlawful consideration, a person having such a possession of the instrument cannot claim any right in respect of any amount due on the negotiable instrument. But if such an instrument is transferred to a person as a holder in due course, he will get a good title. A transferee from holder in due course also gets a clean title as that of the holder in due course himself.

(iii) Another privilege of a holder in due course, as stated in section 120, is that no maker of a promissory note, and no drawer of a bill of exchange or cheque, and no acceptor of a bill of exchange for the honour of the drawer, shall, in a suit thereon by a holder in due course, be permitted to deny the validity of the instrument as originally made or drawn.

(iv) Section 121 provides another privilege of a holder in due course. No maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity at the date of the note or bill, to endorse the same. Against a holder in due course the maker of a promissory note and the acceptor of a bill of exchange are estopped from denying the payee's capacity to endorse the negotiable instrument. Thus, the maker of a promissory note will not be allowed to say that the payee of the note was an insane person and, therefore, the endorsee from him, who is a holder in due course, could not get a good title. There is, however, nothing which can prevent the maker or acceptor to challenge the rights of the endorsee on the ground that the payee's endorsement was forged, as the forged endorsement does not convey a good title even to a holder in due course.

Difference between holder and holder in due course : Following are the notable points of difference between holder and holder in due course.

(i) In case of holder, the existence of consideration is not essential. But it is essential in case of holder in due course (the holder in due course obtains the instrument after paying its full value)

(ii) The most important point of difference is, the interest of the holder in due course is protected though the transferor has defective title. Such protection is not available to holder.

(C) Payment in Due Course (Sec. 10)

Meaning : Payment against negotiable instrument (cheque/bill etc.) should be made to the right person by the banker (or acceptor of the bill). The payment is said to be in due course provided it is made under section 10 of the Negotiable Instruments Act. The Act provides protection for such payment (i.e. payment in due course).

The paying banker can claim protection only if the payment constitutes payment in due course which is defined by Section 10 of the Negotiable Instruments Act as follows : " Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not receive payment of the amount therein mentioned."

Definition : According to Section 10 of the Negotiable Instruments Act, "Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without any negligence to any person in possession thereof under circumstances, which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned."

According to Sec. 10, payment is said to be a payment in due course, when the banker makes such payment under (good faith) a belief that the person (payee) is a bonafide holder and that there is no circumstance to believe that he is making such payment negligently.

Essential Features : A payment to be a payment in due course, the following conditions are to be satisfied.

(i) It(the payment) should be made in accordance with the apparent tenor i.e. in accordance with intention of the parties.

(ii) It should be made in good faith and without any negligence.

(iii) It should be made to the person in possession of the instrument without any suspicion as to title.

Following payments are not payments in due course :

(i) Payment of crossed cheque against counter (like a bearer cheque);

(ii) Payment against post dated cheque;

(iii) Payment against forged instrument;

(iv) Payment against cheque containing alteration and corrections.

(D) Drawee in case of Need

The drawee in case of need is a person whose name is added to the bill of exchange apart from the drawee, to whom the resort may be had in case of need i.e., the Bill being dishonoured by non-payment or non-acceptance.

Section 115 of the Act says that the Bill is not dishonoured unless it is dishonoured by the drawee in case of need. So in case of need, it is the duty of the holder or payee to produce it to drawee in case of need.

In English law he is called referee in case of need. Similar provision is also provided in English Law under Section 15 of Bills of Exchange Act.

(E) Holder for value

The term holder for value is not defined under the Negotiable Instruments Act. According to Sec. 27(2) of the Bills of Exchange Act, (England), where value has at any time been given for a bill, the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to such time.

Whenever the value of the instrument is guaranteed to any holder, he is called holder for value. No consideration is needed i.e. a person who claimed to be a holder, need not be given value, it may be given by a prior party.

Eg:- 'P' the payee of a bill, transfers (endorses) it to 'E' for value. 'E' again transfers it to 'F' without consideration. In this example 'F' is the holder for value. (The transferee/endorsee of an instrument without consideration/value is called the holder for value).

7. ENDORSEMENT

(Negotiation of Negotiable Instruments)

Section 15 of the Negotiable Instruments Act says : "When the Maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for purposes of negotiation, on the back or face thereof, or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same and is called the indorser." Endorsement(Indorsement) is a form of 'negotiation'. Before explaining in detail about the Endorsement, it is necessary to know in brief about the 'negotiation' as follows :

NEGOTIATION : Meaning : Transfer of an instrument from one person to another (so as to make the transferee a holder) is called 'negotiation'. In other words, when the holder of a negotiable instrument, i.e., the person who is entitled

to receive its payment transfers the negotiable instrument to another person so that the transferee now becomes entitled to receive the payment, the instrument is said to be negotiated.

According to Section 14 of the Negotiable Instruments Act, "when a promissory note, bill of exchange or a cheque is transferred to any person, so as to constitute that person, the holder thereof, the instrument is said to be negotiated."

Kinds of Negotiation : Negotiation is of two kinds as follows :

(i) Negotiation by simple delivery (Sec. 47)

(ii) Negotiation by Endorsement (Sec. 48)

(i) Negotiation by simple delivery (Sec. 47) : Bearer instruments are transferable from one person to another by simple delivery. It is, however, necessary that the delivery of the negotiable instrument must have been made with an intention to transfer the ownership, i.e. constitute the transferee as the holder of the instrument, as required by Section 14.

(ii) Negotiation by Endorsement (Sec. 48) : Endorsement means 'signing the instrument', otherwise than as maker for the purpose of negotiation. Endorsement may be made on the very face of the instrument or on the backside or in a slip annexed to the instrument. The person who endorses is called 'Endorser' and the person to whom it is endorsed is called 'Endorsee'.

Object of Endorsement : The following are the objects of endorsement.

(i) At the time of endorsement the endorser has a good title to the instrument.

(ii) The instrument is a genuine one.

(iii) All prior endorsements are genuine and regular.

(iv) The instrument will be duly paid at maturity.

Who may Endorse and Negotiate (Sec. 51) : Every sole maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees, of a negotiable instrument may endorse and negotiate the same unless the negotiability of such instrument has been restricted or excluded as mentioned in Section 51. It is, however, necessary that such maker or drawer who wants to endorse the instrument is in lawful possession of the instrument, or the payee or endorsee who wants to endorse is the holder of this instrument.

Features of Endorsement : Following are the features of Endorsement.

(i) There is no proper procedure to be followed.

(ii) Endorsement may be either on the face of the instrument or on backside of it or in a separate sheet (allonge).

(iii) It requires the signature of the holder or his agent.

(iv) The payee or the holder must sign in his exact name.

(v) Endorsement should be by pen only.

(vi) It need not contain any complimentary words.

(vii) An illiterate can also endorse by thumb impression.

(viii) An endorsement is presumed to have been made in the order in which it appears.

(ix) Endorsement should be for full value.

(x) If married woman endorses then her husband's name is also to be included.

(xi) The endorsement will be completed by delivery.

(xii) In case of signing on behalf of the holder or as an agent, it should make clear by adding the words for or on behalf of.

(xiii) It can be endorsed any number of times.

Kinds of Endorsement : Endorsement of an instrument can be made under the following ways :

(i) Endorsement in Blank or General Endorsement (Sec. 16(1);

(ii) Special Endorsement or Endorsement in full (Sec. 16(1);

(iii) Conditional Endorsement (Sec. 52);

(iv) Restrictive Endorsement (Sec. 50);

(v) Sans recourse Endorsement (Sec. 52); and

(vi) Contingent Endorsement.

(i) General Endorsement (Sec. 16(1) : If the endorsement is made by signature of the endorser without any direction to whom it is endorsed, it is called endorsement in blank or general endorsement.

(ii) Special Endorsement (Sec. 16(1) : If the endorser specifies the name of the person to whom it is endorsed, it is called special endorsement.

(iii) Conditional Endorsement (Sec. 52) : The endorsement is subject to happening of certain event.

(iv) Restrictive Endorsement (Sec. 50): It is a particular type of conditional endorsement. In this case, the endorser by express words restricts the right of endorsee for further endorsement.

(v) Sans recourse Endorsement (Sec. 52) : Sans recourse means without recourse or without liability. In this case, endorser is not liable in case, the instrument is dishonoured.

(vi) Contingent Endorsement : If the liability of the endorser is subject to the happening of a contingency (uncertain event) it is called contingent endorsement.

8. ASSIGNMENT AND NEGOTIATION

The expression assignment literally means 'transfer'. According to section 130 of the Transfer of Property Act, every actionable claim can be transferred by means of a separate instrument in writing duly stamped and signed by the transferor. Negotiable instruments are also actionable claims, and hence can be assigned.

Distinction between 'Assignment' and 'Negotiation' : Despite many similarities, following are the differences between assignment and negotiation.

Assignment	Negotiation
(i) It is effected under Transfer of Property Act, 1882.	(i) It is effected under Negotiable Instruments Act, 1881.
(ii) It requires written document duly signed by the transferor.	(ii) It can be effected by simple Delivery or endorsement.
(iii) Defective title of the instrument affects the assignee.	(iii) Defective title of the instrument does not affect holder in due course.

9. KINDS OF CHEQUES

Cheques may be classified into the following kinds-

(i) Stale Cheque or Out-dated cheque.

(ii) Ante-dated Cheque.

(iii) Mutiliated Cheque and

(iv) Post-dated cheque.

(i) Stale Cheque or Out-dated cheque : A cheque to be honoured, it has to be presented within 6 months from the date of the cheque. If the cheque is presented for payment beyond the 6 months, it is said to be the Stale or Out-dated Cheque. However, an out-dated or Stale cheque may be accepted by the banker for payment if the drawer/customer gives consent to make the payment. Such consent is subject to the period of limitation, which is 3 years. In other words, the drawer of the cheque has to give his consent within 3 years. The period of limitation is 6 years in England.

G. Balakrishna vs. The Official Assignee, Madras & others : It was held in this case that if a cheque is presented beyond 6 months, the holder of the cheque cannot have recourse to the drawer and is not entitled to claim payment against such cheque.

(ii) Ante-dated Cheque : A drawer while drawing cheque gives the date in that cheque prior to the date on which it is drawn (prior to the date means back date). It is called ante-dated cheque. Banker can accept such cheque, if it does not exceed 6 months period.

(iii) Mutiliated Cheque : A cheque which is cut into many pieces is called mutilated cheque. The drawee bank should see in honouring a cheque, whether it is mutilated, cancelled or torn. If the cheque is torn into two or many pieces, it should be returned with the remark 'mutilated cheque'. If he is satisfied that the mutilated cheque gets the original shape of the instrument, he may accept the cheque.

In *Scholey vs. Ramsbottom (1810),* a cheque was torn into four pieces and thrown away and new cheque was drawn which was paid. The torn cheque thereafter presented neatly pasted, though dirty and the drawee bank paid the same. It was held that the drawee bank cannot debit the second cheque because it was dirty and torn.

In *Hongkong & Shanghai Banking Corporation v. Loo Lee Shi (AIR 1928 P.C.)*, it was held that if a cheque is torn accidentally either by the drawer or by the holder, the drawer must confirm it.

(iv) Post-dated cheque : Drawer of a cheque gives the date in the cheque later or after the date on which it is drawn. It is known as post-dated cheque. The banker must accept the post-dated cheque only after the ostensible date given on the cheque. If he accepts before, he has to face many consequences.

10. MARKING OF CHEQUES

The expression 'Marking of Cheque' denotes "certification of cheque by an authorized person in a bank". The authorized person in the bank certifies the cheque by writing on the face of the cheque, "Approved" or "Good for Payment" and then signs on the cheque.

Effect of Marking : By way of marking, it is implied that at the time of marking, the cheque has satisfied all its requirements and it is properly submitted and also that the customer is having sufficient amount in his account to meet this cheque.

Who can mark the cheque ? : Only a banker can mark the cheque.

Who can request the banker to mark the cheque ? : The following persons are entitled to request the banker to mark the cheque.

(A) Marking at the instance of the drawer or customer.

(B) Marking at the instance of the holder.

(C) Marking by the Banker.

(A) Marking at the instance of the drawer or customer : When the banker marks the cheque with the request of the customer, then it is called marking at the instance of the customer. If it is a marking at the request of the customer, the banker must keep some amount separately for the purpose of meeting this marked cheque whenever it is presented because it amounts to constructive payment.

(B) Marking at the instance of the holder : When the banker marks the cheque with the request of the holder, then it is called marking at the instance of holder. It is merely certifying the cheque. There is no obligation to the banker to keep the money for this cheque.

(C) Marking at the request of a Banker : It is common that one banker may also request another banker for marking the cheque when he thinks so. It does not mean that the banker who marked the cheque is completely liable over the cheque. It only means that at the time of marking, the cheque is 'good for payment'. So in this type of marking, the collecting banker generally presents the cheque for collection immediately.

Marking of Post dated cheque : Marking of post dated cheque is dangerous to the banker. The marking of general cheque certifies that at the time of marking the cheque is 'good for payment' and it may be accepted within a reasonable time. The important case on marking of post-dated cheque is, *Punjab National Bank vs. Bank of Baroda (1914, P.C. 58)*

In this case a post-dated cheque for Rs. 2,75,000/- drawn on Bank of Baroda, Calcutta Branch was marked as 'good for payment' on the request of Punjab National Bank. Punjab National Bank paid the entire money to his customer before the ostensible date and cheque was sent for collection on the ostensible date to Bank of Baroda. Bank of Baroda rejected the payment. Punjab National Bank challenged the significance of marking, however, it was held that Bank of Baroda was not responsible to pay the post-dated cheque and the following aspects are also observed in this case.

(a) Cheque is special bill of exchange which needs no acceptance.

(b) Both M.Chalmers and Sir John Paget are of the opinion that Marking or certification, neither in form nor in effect, may be deemed an acceptance of which the holder or payee can avail himself of.

(c) Both in England as well as in India marking is judicially recognized only for clearance purposes.

(d) Marking is deemed as a gentleman's agreement or honourable obligation, which has no validity in Law.

(e) There is no custom or usage which impose responsibility on the marked bank.

(f) There is no promise made by Bank of Baroda to Punjab National Bank with regard to the payment.

(g) Marking of post-dated cheque generally will not give any liability to the drawee bank, and

(h) The manager of Bank of Baroda was not ostensible authority to mark the cheque.

11. MATERIAL ALTERATION

What is Material Alteration : Any alteration made in the instrument which effects the legal validity of the instrument or which changes the rights and responsibilities of the parties to the instrument, is called material alteration.

What is the effect of Material Alteration : Sec. 87 of the Act states as follows :

"Any material alteration of negotiable instrument renders the same void as against any one who is party thereto, at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties.

And any such alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof."

The provisions of this section are subjected to those of sections 20, 49, 86 and 125.

What are the instances of Material Alteration : The following are the instances of material alteration.

(i) Alteration of date

(ii) Alteration of time

(iii) Alteration of place

(iv) Alteration of amount

(v) Alteration of parties

(vi) Alteration of rate of interest

(vii) Converting order instrument into bearer instrument

(viii) Affixing more stamps to the instrument.

Alteration not vitiating the instrument : The following alterations are not considered as material alteration.

(i) If it is made before issuing.

(ii) If it is done for the purpose of correction.

(iii) If it is made to carry on the intention of the drawer.

(iv) If it is done with the consent of the parties, and

(v) Where it is immaterial alteration.

Alteration Authorised by Law : The following alteration are authorized by law and they cannot be considered as material alteration.

(i) Filling the blanks in inchoate instrument(Section 28).

(ii) Converting blank endorsement into special endorsement (Section 49).

(iii) Crossing of Cheque(Section 125).

Banker's responsibility over the materially altered cheques :

Section 89 protects the interest of the paying banker when he pays the amount over the materially altered instruments. However, material alteration discharges the liability of the banker over the cheques. He can reject the payment over the instruments materially altered. If banker pays the amount over materially

altered instruments, his interest would be protected provided the following conditions are satisfied.

(i) When such alteration is not apparent.

(ii) When the banker has made the payment in due course and

(iii) When the banker is liable to that cheque.

However, whether the instrument is altered or not that is a question of law decided by the court, which depends much upon the circumstances of each case. The following are some of the cases in this regard.

Tanjor Permanent Bank Limited vs. S.R. Rangachari, (AIR 1959, Mad. 119) :

In this case the statutory protection was rejected to the paying banker because of the fact that the alterations were material and apparent and were not authorised by the drawer.

Brahma Shum Sher Jung Bhadar vs. Chartered Bank of India, Australia and China, (AIR 1956, Act 399):

Here paying banker obtained the statutory protection because the alteration was not apparent. It was held that the instrument on its face did not disclose any trace of alteration therefore the drawee bank was entitled for a statutory protection.

Dick Joice vs. The Bank of India Ltd., (1933 Suit No. 548/1932 Sm.CC Court, Bombay) :

In this case a cheque was altered materially by a chemical process in every part except the drawer's signature and such alteration was not apparently clear. When cheque was presented it was duly paid by the banker in good faith and without negligence. It was held that the bank was entitled to statutory protection under sec. 89 of the Negotiable Instruments Act because the alteration was not apparent and effected in due course.

However, customer must also take reasonable care over the instrument. He should not allow any person by his negligence to alter the instrument. If it is their, he has to bear the loss caused to him due to any alteration. The following are the some of the cases in this regard :

Young vs. Grote, (1827, 4 bing 253) :

In this case, Young gave his wife five cheques signed in blank to be used by her for his business as and when necessary. Mr. Young gave one of the cheque to a clerk to be filled up for Rs. 50-2-3. The clerk filled it in such a way that he

would alter the amount both in words and figures to Rs. 350-2-3. The alteration was so made that it could not be detected. It was held that the customer acted negligently and therefore had to bear the loss. This decision was reversed in Colonial Bank of Australia v. Marshall (1906, A.C. 549) and decision was given in favour of the customer.

London Joint Stock Bank vs. Macmillan & Arthur, (1918, A.C. 77) :

In this case, the decision of Young v. Grote was confirmed again. In this case a clerk in the firm of Macmillan & Arthur prepared a cheque for 2 pounds with space left before and after 2 pound, and with no amount written on the body of the cheque. After obtaining the signature of the partner in the firm, the clerk altered the amount to 120 pound. He then encashed the cheque at the counter and absconded. It was held that the banker was entitled to debit the customer's account with 120 pound because the alteration was not apparent and the customer, by his carelessness in drawing the cheque had facilitated the alteration.

The Statutory Protection over the materially altered instrument is recognized in England under Section 64 and 68 of Bills of Exchange Act. By observing the above aspects we can say that the statutory protection is recognized to the paying banker in many sections either in England or in India provided the payment amounts to the payment in due course.

12. FORGERY OF CUSTOMER'S SIGNATURE

(Payment of forged cheque)

While opening an account with the bank, the customer is required to give/ supply to the banker, this specimen signature. The general rule is that the banker is expected to be familiar with the signature of his customer. If the signature is forged, the banker should not honour the cheque. If he honours, he cannot debit the customer's account with the amount so paid. Therefore, the paying banker must be very careful while comparing the signature on the cheque with the specimen signature. The signature must be on the face of the cheque. In case, the drawer changes his signature and communicates the same to the banker, it is effective from the date specified therein.

A cheque with forged signature is a nullity and the banker has no obligation to make payment. Payment against forged cheque is deemed to be a payment without authority of the customer, and it amounts to breach of implied contract between the banker and the customer. Further, the paying banker is not given any statutory protection. The banker bears the liability even if the drawer's signature is so cleverly forged and the same could not be detected despite

reasonable degree of care and scrutiny. The banker is liable, even if the drawer (customer) was negligent in keeping the cheque book under lock and key as laid down by the Allahabad High Court *in L.P.Dayal v. Jwala Bank ltd.*

The Supreme Court in *–Bihta Co-operative Development and Cane Marketing Union Ltd vs. Bank of Bihar Ltd.*, held that leaving cheque book carelessly by the customer affords no defence to the bank.

Obligation on the part of customer : The customer has the following obligations to protect the banker from forged cheques :

(i) He has an obligation to keep the cheque book under lock and key and must communicate the banker in case the cheque book or leaves therein is lost/found missing.

(ii) If the customer is doubtful that a cheque with forged signature is going to be presented for payment, he must inform the banker immediately.

(iii) If the customer fails to inform about the above forged cheques, the banker loses his right against the forger and the customer is estopped from denying the genuineness of his signature.

Exceptions : The above general rule that the customer's account cannot be debited in respect of payment against the forged cheque is subject to the following exceptions.

(i) Contributory Negligence : It means both parties (i.e. banker and customer) contributed for the negligent act i.e. payment against the forged cheque. In other words, both the banker and the customer are responsible. If the customer is guilty of contributory negligence, his account can be debited with the amount paid against the forged cheque.

(ii) Misleading : If the customer by his conduct misleads the bank so that the payment is made against the forged cheque, the banker affords defence to debit the customer's account.

13. NOTICE OF DISHONOUR

What is Dishonour ? : When a promissory note or bill of exchange or cheque is rejected by the drawee for payment, then it amounts to dishonour of the instrument.

Types of Dishonour : Dishonour is of two types .

(i) Dishonour by non-acceptance and

(ii) Dishonour by non-payment.

(i) Dishonour by non-Acceptance (Sec. 91) : The following are the instances which amounts to dishonour by non-acceptance.

(a) When drawee refuses to accept

(b) When drawee becomes incompetent

(c) When drawee gives qualified acceptance

(d) When drawee's present is excused.

(ii) Dishonour by Non-Payment : It is common for every instrument when any person in the negotiable instrument fails to pay the money to the person entitled in it, then it amounts to dishonour by non-payment.

Whenever any negotiable instrument is dishonoured, a notice on the part of that claimant is necessary. It is nothing but to warn the drawee or other persons for its dishonour. So notice of dishonour should be served to the parties responsible in the instrument.

Notice by Whom : By holder or by any person who is entitled to get the money.

Notice to Whom : Notice should be given to dishonoured persons generally, but sec.94 says that notice should be given to :

(i) Authorised agent to whom it is required to be given.

(ii) Legal representative, when the drawee or endorsee is died.

(iii) Official Assignees or Receiver, when the party to whom the notice is required to be given has been declared as an insolvent.

Effects of omission to give notice : Sec. 38 and 35 of Negotiable Instruments Act requires the notice of dishonour to the endorsee as well as endorser respectively without which they are not responsible.

Mode of Notice : There is no proper procedure for Notices. It may be oral or in writing. Only thing required here is the information should reach the responsible person.

14. CRIMINAL LIABILITY OF THE DRAWER OF A CHEQUE

(Cheque Bouncing)

Till recently, the drawer of a cheque was subject to civil liability only in respect of the money due on a cheque, if it was dishonoured for reasons whatsoever. With the enforcement of Banking, Public Financial Institutions and Negotiable

Instrument Laws (Amendment) Act, 1988 on April 1, 1989, dishonour of cheques because of insufficiency of funds, is now deemed as an offence for which the drawer may be punished with imprisonment for a term up to one year or with fine up to twice the amount of the cheque or with both. Such a punishment will be in addition to his liability in a civil suit. Section 138 to 142 which have been inserted in the newly added Chapter XVII to the Negotiable Instruments Act, 1881 provide for conditions, procedure and punishment for criminal liability of the drawer.

The last Chapter containing 5 sections dealing with the following aspects :

(a) Dishonour of cheque for insufficiency of funds etc. (Sec. 138)

(b) Presumptions in favour of holder (Sec.139)

(c) Defence which may not be allowed in any prosecution under Sec. 138(Sec. 140)

(d) Offences by companies (Sec. 141)

(e) Cognizance of Offence (Sec. 142).

The following aspects are generally covered under Chapter XVII of the Act for fixing the criminal liability of the drawer :

(a) The cheque has been issued in discharge of a debt or other liability in whole or in part.

(b) The cheque should be presented to the paying banker in time i.e. within 6 months or its specific validity period, whichever is earlier.

(c) The dishonour of cheque should be on account of insufficiency of funds only – either the amount of money standing to the credit of the account is insufficient or that the amount of cheque exceeds the amount arranged to be paid from that account by an agreement with the bank.

(d) The payee or holder in due course should give notice in writing to the drawer demanding payment within 15 days of his receiving information of dishonour.

(e) The drawer can make payment within 15 days of the receipt of the notice, if he fails to do so, prosecution can take place.

(f) The complaint can be made within one month of the cause if action arising (i.e. expiry of 15 days time given to the drawer to make payment)

(g) No court lower to that of metropolitan Magistrate or Judicial Magistrate of 1st class will try the offence.

Section 140 makes it quite clear that the drawer of the dishonoured cheques cannot defend himself on the ground that he had no reason to believe when he issued the cheque that the cheque may be dishonoured or presentation on account of insufficiency of funds.

If the dishonoured cheque is drawn on behalf of a company, a firm or association of individuals every person who was in charge of and was responsible to the company or the firm for the conduct of its business, at the time the offence was committed, and also the company shall be deemed to be guilty of the offence. But if any such person proves that the offence was committed without his knowledge or that he had exercised all due deligence to prevent the commission of such an offence, he will not be liable for punishment (Section 141 of the Act).

Clarifications :

(a) Complaint is to be lodged with **criminal court** and not with **police** (Sec. 142 C)

(b) The cheque should pertain to the DEBT which is alive and not barred by limitation (Sec. 138 C).

(c) Complaint is to be lodged against the person who has issued the cheque. If cheque is issued by a company, then "person" means "every person who is responsible for the conduct of the business of company" (Sec. 140).

15. THE PAYING BANKER

(Statutory Protection to the Paying Banker)

Paying Banker : Paying Banker, in the simple sense means the banker, who makes payments against his customers' cheques. A Banker has a statutory obligation to honour customer's cheques. Payment of cheques involves great risk, since the banker is liable for wrongful dishonour. In order to minimize such risks and losses to paying banker, the Negotiable Instruments Act, 1881 provides statutory protection to him.

Risks not covered/protected under the Act : There are certain risks incurred by a paying banker, for which statutory protection is not available under the Act.

(i) Forgery of drawer's signature and

(ii) Fraudulent alterations of the cheque such as alteration of the amount, payee etc.

Protection in case of Order Cheques (Sec. 85(1) : Where a banker makes payment against an order cheque with forged endorsement, the drawee (paying banker) is discharged from liability. After insertion of Sec. 16(2) this protection is extended to other endorsements also. To avail the statutory protection under section 85(1) the following two conditions are to be satisfied :

(i) The endorsement must be regular, and

(ii) The payment must be in due course (i.e. U/s.10)

United Bank of India v. A.T. Ali Hussain & Co.(AIR 1978 Cal. 169) : The plaintiff paying banker made payment of Rs. 5200/- against a forged cheque to A.T.A. H.Co. through their banker Union Bank of India. It was found that the forgery could not be detected even by authorised signatory (A/c holder) or trained expert. Calcutta High Court granted protection to the plaintiff bank.

Protection in case of Bearer Cheque (Sec. 85(2) : According to Sec. 85(2) the paying banker is not required to verify the regularity of endorsements on bearer cheques. In such cases, the banker is discharged from the liability. Even if the banker makes payment against stolen bearer cheque, he is discharged from liability.

Protection in case of crossed cheques (Sec. 128) : Section 128 protects paying banker in case of payment against crossed cheques. Crossing of cheques denotes payment in accordance with the instruction of the drawer. The protection under section 128 is available if the following two conditions are satisfied :

(i) If the payment is made in due course U/s. 10 and

(ii) Such payment is made in accordance with the requirement of crossing under sec. 126 i.e. through any banker in case of general crossing and through the particular banker in case of special crossing.

Exceptions : The protection U/s. 128 is not available to paying banker in the following cases :

(i) If the payment against crossed cheque is made in case there is irregular endorsement, or

(ii) If there is a material alteration on the cheque, or

(iii) Forged signature of the drawer.

Liability of paying banker : The paying banker is under statutory obligation to honour his customer's cheques. Otherwise, he is liable under section

31 of the Act to compensate the drawer (customer) for any loss he may suffer. This duty/liability under section 31 of the Act is subject to the fulfillment of the following conditions :

(i) There must subsist the banker and customer relationship, i.e. the account must not have been closed.

(ii) The customer must have sufficient funds to honour the cheque.

(iii) The banker is under obligation to pay the cheque "only when duly required to do so".

It means

(i) the cheque is presented in the branch, where his account is kept,

(ii) it is presented during banking hours, and

(iii) the funds are properly applicable to the cheque.

Liability for wrongful dishonour : If the paying banker wrongfully dishonours a customer's cheque, he is liable for damages to the customer.

16. THE COLLECTING BANKER

(Statutory Protection to the Collecting Banker)

Collecting Banker : Collecting banker is one, who in discharge of agency services, collects cheques/bills of exchange etc., on behalf of his customers. Collection of cheques involves great risk and hence the collecting banker has been provided statutory protection under the Negotiable Instruments Act, 1881 (Section 131).

Conditions : A collecting banker is entitled to statutory protection, provided the following conditions are fulfilled.

(i) The cheque must be a crossed cheque;

(ii) The payment must be received for a customer ;

(iii) The payment must be received in a good faith and without any negligence.

(I) The Cheque must be crossed : The collecting banker gets statutory protection in case of crossed cheques only. The crossing may be general or special. Otherwise, he is liable for conversion, defective title (of the cheque) etc. (Sec. 128). Section 131-A extends this protection to crossed bank drafts also.

(II) Collection for customer only : The statutory protection is available to the collecting banker if he collects the cheque as an agent of the customer, not as

a holder for its value (holder for value means when a customer presents an outstation cheque for collection and the banker gives immediate credit to his customer's account without waiting for its clearance, then the position of banker is holder for value). A customer is one, who has an account with the banker and his dealings with the banker in the nature of banking business.

(iii) In good faith and without negligence : The collecting banker is entitled to avail statutory protection when he receives payment in good faith and without negligence. A thing is deemed to be in good faith when it is done honestly.

Conversion : Section 131 affords protection to collecting banker, that he is not liable to the true owner for conversion even though his customer's title to the cheque proves defective provided the following conditions are satisfied :

(i) It is a crossed cheque;

(ii) he has received payment as an agent for collection, and not on his own behalf as a holder;

(iii) he has collected the cheque for a customer in good faith and without any negligence.

17. CLOSING OF A BANK ACCOUNT

The relationship between a banker and a customer exists/begins by opening of an account. This relationship extents (comes to an end) when the account is closed. The proposal to close the account may come from the customer or banker. When the customer requests the bank to close his account, it is referred to (called) as 'Closing an Account'. Similarly, when the banker takes initiative to close the account, it is referred to as 'stopping of account'.

Closing an Account : When a customer requests the banker in writing to close his account, the banker is bound to close the same. He(banker) should not ask the reasons and the customer is required to return the unused cheques.

A customer may get his account closed by withdrawing the balance standing to his credit or liquidating the outstandings in his account. An account cannot be treated as closed even if it shows 'nil' balance, until and unless the customer's request/direction to that effect has been received. The account may be closed even if the unused cheques are not returned. However, efforts should be continued to recover unused cheque leaves.

Stopping an account : A banker may take steps to stop his customer's account, which is found to be undesirable. The banker must give due notice to the customer, of his intention to close the account and request him to withdraw

the balance standing to his credit. The banker takes such extreme step to stop his customer's account under the following circumstances :

(i) Mis-use ;

(ii) Un-operated account ;

(iii) Insanity of customer ;

(iv) Insolvency of customer ;

(v) Death of customer ;

(vi) Garnishee order ; and

(vii) Assignment.

(i) Mis-use : When the customer is guilty of misusing the account viz. forging cheques, bills of exchange, issuing cheques without sufficient balance, failure to pay back (repay) loans, overdrafts etc.

(ii) Un-operated account :When an account of his customer remains un-operated for a long time, the banker may presume that he needs no longer the account and communicate him to withdraw the amount. Despite reasonable efforts, if the customer has not been traced, the banker may transfer the balance at his credit to an 'unclaimed deposit account' and the account is closed. The balance shall be paid to the customer, as and when, he is traced.

(iii) Insanity of customer :When a banker receives notice regarding insanity of his customer, he has to stop payments against the account.

(iv) Insolvency of customer :If the customer becomes insolvent, he is deprived of operating the account. The banker has to transfer the balance (standing to customer's account) to the Official Receiver of the insolvent customer.

(v) Death of customer :When the customer dies, the banker must stop operation of his customer's account.

(vi) Garnishee order : When the banker receives a Garnishee Order from the court, he is bound to suspend the operation of his customer's account.

(vii) Assignment : Assignment simply means transfer, when the banker receives a notice of assignment of the credit balance of his customer's account to a third party, the banker is bound to pay/transfer the same to such third party.